

2570
No. 11818

United States
Circuit Court of Appeals
For the Ninth Circuit

ANNIS VAN NUYS SCHWEPPE,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court
of the United States

FILED
MAR -4 1948

PAUL P. GRIFFIN

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1887

January 1st - New Year's Day
February 1st - Valentine's Day
March 1st - St. Patrick's Day
April 1st - Good Friday
May 1st - Mother's Day
June 1st - Father's Day
July 1st - Independence Day
August 1st - Labor Day
September 1st - National Day
October 1st - Halloween
November 1st - Thanksgiving
December 1st - Christmas

1887

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October 1st - Halloween
November 1st - Thanksgiving
December 1st - Christmas

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

W. JOSEPH McFARLAND,
MAYNARD J. TOLL,
SIDNEY H. WALL,
 withdrawn.

ELMO H. CONLEY,
BERT A. LEWIS.

For Commissioner:

E. A. TONJES.

Tax Court of the United States

Docket No. 6415

ANNIS VAN NUYS SCHWEPPE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1944

Nov. 4—Petition received and filed. Taxpayer notified. Fee paid.

Nov. 4—Request for Circuit hearing in Los Angeles, Calif., filed by taxpayer. 11/28/44 Granted.

Nov. 21—Copy of petition served on General Counsel.

Dec. 6—Entry of appearance of Maynard J. Toll as counsel filed.

Dec. 28—Answer filed by General Counsel.

1945

Jan. 10—Copy of answer served on taxpayer, Los Angeles, California.

1946

Apr. 16—Hearing set June 10, 1946, Los Angeles, Calif.

1946

June 12—Hearing had before Judge Black on merits. Appearance of Sidney H. Wall as counsel and stipulation of facts with exhibits attached filed at hearing. Petitioner's brief due 8/1/46. Respondent's brief due 9/1/46. Petitioner's reply brief due 10/1/46.

July 8—Transcript of hearing, June 12, 1946, filed.

July 29—Brief filed by taxpayer. Copy served.

Aug. 27—Motion for extension to Oct. 1, 1946, to file respondent's brief and Nov. 1, 1946, to file petitioner's reply brief filed by General Counsel. 8/28/46 Granted.

Oct. 3—Motion for leave to file the attached reply brief, brief lodged, filed by General Counsel. 10/3/46 Granted and Served 10/4/46.

Oct. 31—Reply brief filed by taxpayer. Copy served.

1947

June 19—Findings of fact and opinion rendered, Judge Black. Decision will be entered under Rule 50. Copy served 6/20/47.

Aug. 7—Respondent's computation for entry of decision filed.

Aug. 12—Hearing set Sept. 17, 1947, Washington, D. C., on Rule 50.

Aug. 26—Consent to Respondent's computation filed.

1947

Aug. 28—Decision entered, Judge Black, Div. 15.

Sept. 8—Motion for leave to withdraw W. Joseph McFarland, Maynard J. Toll, and Sidney H. Wall as counsel filed. 9/9/47 Granted.

Sept. 8—Entry of appearance of Elmo H. Conley, and Bert A. Lewis as counsel filed.

Nov. 14—Petition for review by U. S. Circuit Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.

Nov. 20—Proof of service filed.

Dec. 17—Praecipe for record filed by taxpayer.

Dec. 17—Stipulation settling record filed.

[Title of Tax Court and Cause.]

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols LA:IT:90D:PD) dated August 10th, 1944, and as the basis of her proceedings, alleges as follows:

1. The petitioner is an individual residing in Los Angeles, California, and having an office at 210 West Seventh Street in that city. The return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to petitioner on or after August 10th, 1944.

3. The taxes in controversy are income taxes for the calendar year 1940 in the amount of \$10,110.78 and for the [2*] calendar year 1941 in the amount of \$17,721.81 being a total of \$27,832.59. The amount of the deficiency asserted by the Commissioner for said years totals \$30,716.53.

Assignments of Error

4. The determination of taxes set forth in said notice of deficiency is based upon the following errors:

(a) In determining the taxable net income of the petitioner for the years 1940 and 1941, the Commissioner erroneously included all distributions received by petitioner during said years from the I. N. Van Nuys Building Company.

(b) In determining the taxable net income of the petitioner for the years 1940 and 1941 the Commissioner erroneously failed to allow the proper deduction for depreciation on certain buildings used for the production of income.

(c) In determining the taxable net income of the petitioner for the year 1941, the Commissioner erred in his determination of the fair market value of certain property received by petitioner upon complete liquidation of Bolsa Land Company.

* Page numbering appearing at top of page of original certified Transcript.

Facts

5. The facts upon which petitioner relies as a basis of this proceeding are as follows: [3]

(a) The petitioner was, during the years 1940 and 1941, the owner of one-third of the outstanding capital stock of the I. N. Van Nuys Building Company.

(b) In the years 1940 and 1941 petitioner received upon said stock of the I. N. Van Nuys Building Company distributions in cash of \$35,246.38 and \$24,149.16, respectively.

(c) Of said distributions only the amounts of \$10,746.62 for the year 1940 and \$3,128.02 for the year 1941 constituted distributions from said corporation's earnings or profits accumulated after February 28th, 1913, or from said corporation's earnings or profits of either or any of said corporation's taxable years within which said distributions were made.

(d) The balance of said distributions constituted a return of capital to the petitioner.

(e) The stock owned by petitioner in said corporation was held by her at an unadjusted basis which exceeded the total amount of distributions constituting returns of capital made at any time or times prior to January 1st, 1942.

(f) The depreciation taken by the petitioner during the years in question is reasonable, in accordance with the requirements of the Internal Revenue

Code, and agrees with the deductions taken in preceding years and approved by the Treasury [4] Department.

(g) On December 19th, 1941, petitioner was the owner of twenty-five (25) shares of the capital stock of Bolsa Land Company, which petitioner acquired by bequest, devise or inheritance, as of May 12th, 1940, at a basis of \$25,000.00 as determined by the Commissioner of Internal Revenue as fully set forth in the notice of deficiency, a copy of which is hereto attached.

(h) On or about December 19th, 1941, the Bolsa Land Company completely liquidated and distributed its assets to its shareholders, and at such time the petitioner received her proportionate share of the assets so distributed.

(i) The fair market value of the property distributed to petitioner upon such dissolution was not in excess of \$37,772.20.

Wherefore, Petitioner prays that this court may hear the proceeding, and,

1. Redetermine the amounts of the aforesaid deficiencies determined by the Commissioner of Internal Revenue, and

2. Grant the petitioner such other and further relief as the court may find just and proper.

W. JOSEPH McFARLAND and
MAYNARD J. TOLL,

By /s/ W. JOS. McFARLAND,
Counsel for Petitioner. [5]

State of California,
County of Los Angeles—ss.

Annis Van Nuys Schweppe, being duly sworn, says that she is the petitioner above named; that she has read the foregoing petition, or has had the same read to her, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts she believes to be true.

ANNIS VAN NUYS SCHWEPPE

Subscribed and sworn to before me this 2nd day of November, 1944.

[Seal] AGNES E. SHULTZ,
Notary Public in and for the County of Los Angeles, State of California.

My commission expires Aug. 31, 1947.

I hereby certify that the foregoing is a true copy of the petition to The Tax Court of the United States signed by me on November 2, 1944.

/s/ W. JOS. McFARLAND

EXHIBIT A

[Letterhead Treasury Department]

Aug. 10, 1944

Office of Internal Revenue Agent in Charge Los
Angeles Division LA:IT:90D:PB

Mrs. Annis Van Nuys Schweppe
210 West Seventh Street
Los Angeles 14, California

Dear Mrs. Schweppe:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1940 and 1941 discloses a deficiency of \$30,716.53, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an

early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier,

Very truly yours,

JOSEPH D. NUNAN, Jr.,

Commissioner,

By GEORGE D. MARTIN,

Internal Revenue Agent in
Charge.

Enclosures:

Statement

Form of waiver.

Statement

Mrs. Annis Van Nuys Schweppe

210 West Seventh Street

Los Angeles 14, California

Tax Liability for the Taxable Years Ended
December 31, 1940 and 1941

Income Tax

Year	Liability	Assessed	Deficiency
1940.....	\$12,762.12	\$2,651.34	\$10,110.78
1941.....	22,015.14	1,409.39	20,605.75
Total	\$34,777.26	\$4,060.73	\$30,716.53

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated February 3, 1943,

to your protest dated March 30, 1943, and to the statements made at the conferences held.

The entire amounts distributed to you during the years 1940 and 1941 as a stockholder of the I. N. Van Nuys Building Company are determined to constitute taxable dividends under the provisions of section 115 of the Internal Revenue Code. Accordingly, dividend income from that source has been increased from \$10,746.62 to \$35,246.38 for 1940 and from \$3,128.02 to \$24,149.16 for 1941.

A copy of this letter and statement has been mailed to your representative, Mr. Maynard J. Toll, 433 South Spring Street, Los Angeles 13, California, in accordance with the authority contained in the power of attorney executed by you. [8]

Adjustments to Net Income

Taxable Year Ended December 31, 1940

Net income as disclosed by return.....		\$20,192.88
Additional income and unallowable deductions:		
(a) Dividends received	\$24,499.76	
(b) Depreciation disallowed.....	2,992.69	\$27,492.45
	<hr/>	<hr/>
Total.....		\$47,685.33
Additional deduction:		
(c) Contributions		1,810.39
		<hr/>
Net income adjusted.....		\$45,874.94

Explanation of Adjustments

(a) This represents the increase in dividends received from I. N. Van Nuys Building Company, as previously explained.

(b) Depreciation has been adjusted under the provisions of section 23(1) of the Internal Revenue Code as follows:

Property	Claimed	Allowed	Disallowed
424 South Broadway Building..	\$4,803.60	\$2,530.91	\$2,272.69
San Francisco Building.....	1,200.00	480.00	720.00
Total.....	<u>\$6,003.60</u>	<u>\$3,010.91</u>	<u>\$2,992.69</u>

(c) As a result of the above adjustments an additional deduction for contributions is allowed in the amount of 1,810.39, the total amount paid being \$5,374.00 and the amount claimed as a deduction being \$3,563.61. Section 23(o) of the Internal Revenue Code. [9]

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1940

Net income adjusted.....	\$45,874.94
Plus: Net long-term capital loss.....	1,302.37
Ordinary net income.....	<u>\$47,177.31</u>
Less: Personal Exemption.....	1,200.00
Balance (surtax net income).....	<u>\$45,977.31</u>
Less: Earned income credit.....	300.00
Net income subject to normal tax..	<u>\$45,677.31</u>
Normal tax at 4% on \$45,677.31.....	\$ 1,827.09
Surtax on\$45,977.31.....	10,170.92
Partial tax.....	<u>\$11,998.01</u>
Minus: 30% of net long-term capital loss	390.71
Alternative tax.....	<u>\$11,607.30</u>

COMPUTATION OF TAX

Taxable Year Ended December 31, 1940

Net Income Adjusted.....	\$45,874.94
Less: Personal exemption.....	1,200.00
	<hr/>
Balance (surtax net income).....	\$44,674.94
Less: Earned income credit.....	300.00
	<hr/>
Net income subject to normal tax....	\$44,374.94
Normal tax at 4% on \$44,374.94.....	\$ 1,775.00
Surtax on.....\$44,674.94.....	9,649.98
	<hr/>
Total	\$11,424.98
Alternative tax.....	\$11,607.30
Defense tax (10% of \$11,607.30).....	1,160.73
	<hr/>
Total income tax.....	\$12,768.03
Less: Income tax paid at source.....	5.91
	<hr/>
Correct income tax liability.....	\$12,762.12
Income tax assessed:	
Original, account No. 207442.....	2,651.34
	<hr/>
Deficiency of income tax.....	\$10,110.78

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1941

Net income as disclosed by return.....	\$ 8,434.30
Additional income and unallowable deductions:	
(a) Dividends received.....	\$21,021.14
(b) Depreciation disallowed.....	2,992.69
(c) Capital gain adjustments.....	28,797.40
(d) Rental income.....	7,000.00
	<hr/>
Total	\$68,245.53
Reductions in income:	
(e) Income from estate.....	\$ 6,907.07
(f) Contributions	3,973.42
	<hr/>
Net income adjusted.....	\$57,365.04

Explanation of Adjustments

(a) This represents the increase in dividends received from I. N. Van Nuys Building Company, as previously explained. [11]

(b) Depreciation has been adjusted under the provisions of Section 23(1) of the Internal Revenue Code as follows:

Property	Claimed	Allowed	Disallowed
424 South Broadway Building..	\$4,803.60	\$2,530.91	\$2,272.69
San Francisco Building.....	1,200.00	480.00	720.00
Total.....	\$6,003.60	\$3,010.91	\$2,992.69

(c) Short-term capital gain reported in the amount of \$2,772.20 on account of distributions received in complete liquidation of Bolsa Land Company has been adjusted to a long-term capital gain of \$30,852.51 under the provisions of sections 113, 115 and 117 of the Internal Revenue Code. It is determined that you acquired twenty-five (25) shares of capital stock of that corporation by bequest, devise or inheritance as of May 12, 1940, at a basis of \$25,000.00; that the fair market value of the money and property received in complete liquidation thereof was \$71,278.77; and that the asset having been held for more than eighteen (18) months but not more than twenty-four (24) months, 66 $\frac{2}{3}$ per cent of the gain received is to be taken into account in computing net income. As a result of this adjustment an addition to income is made in the amount of \$28,080.31.

The long-term capital gain from installment sale, reported in the amount of \$2,650.62, has been determined in the amount of \$3,367.71, an addition to income of \$717.09.

These adjustments result in the addition to income of \$28,797.40, and the determination of net long-term capital gain in the amount of \$10,412.90 in lieu of net long-term capital loss reported in the amount of \$21,156.70.

(d) Rental income from San Francisco building has been determined in the amount of \$19,000.00, in lieu of \$12,000.00 reported in item 9 of your return.

(e) The income reported in item 9 of your return as distributive share of income of the Estate of R. J. Schweppe, Deceased, is eliminated. [12]

(f) As a result of the above adjustments an additional deduction for contributions is allowed in the amount of \$3,973.42, the total amount paid being \$5,461.83 and the amount claimed as a deduction being \$1,488.41. Section 23(o) of the Internal Revenue Code.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1941

Net income adjusted.....		\$57,365.04
Minus: Net long-term capital gain.....		10,412.90
		<hr/>
Ordinary net income.....		\$46,952.14
Less: Personal exemption.....	\$ 750.00	
Credit for dependents.....	400.00	1,150.00
		<hr/>
Balance (surtax net income).....		\$45,802.14
Less: Earned income credit.....		300.00
		<hr/>
Net income subject to normal tax..		\$45,502.14
Normal tax at 4% on \$45,502.14.....	\$ 1,820.09	
Surtax on\$45,802.14.....	17,071.18	
Partial tax.....		\$18,891.27
Plus: 30% of net long-term capital gain		3,123.87
		<hr/>
Alternative tax.....		\$22,015.14

COMPUTATION OF TAX

Taxable Year Ended December 31, 1941

Net Income Adjusted.....		\$57,365.04
Less: Personal exemption.....	\$ 750.00	
Credit for dependents.....	400.00	1,150.00
		<hr/>
Balance (surtax net income).....		\$56,215.04
Less: Earned income credit.....		300.00
		<hr/>
Net income subject to normal tax....		\$55,915.04
Normal tax at 4% on \$55,915.04.....	\$ 2,236.60	
Surtax on\$56,215.04.....	22,922.57	
		<hr/>
Total		\$25,159.17
Alternative tax.....		\$22,015.14
Correct income tax liability.....		\$22,015.14
Income tax assessed:		
Original, account No. 931851.....		1,409.39
		<hr/>
Deficiency of income tax.....		\$20,605.75

Received and filed Nov. 4, 1944.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1940 and for the calendar year 1941. Admits that the amount of the deficiency asserted by the Commissioner for said years totals \$30,716.53; denies the remainder of the allegations contained in paragraph 3 of the petition.

4. Denies the allegations of error contained in paragraph 4 of the petition.

5. (a) and (b) Admits the allegation contained in subparagraphs (a) and (b) of paragraph 5 of the petition. [15]

(c) to (f), inclusive. Denies the allegations contained in subparagraphs (c) to (f), inclusive, of paragraph 5 of the petition.

(g) and (h) Admits the allegations contained in subparagraphs (g) and (h), of paragraph 5 of the petition.

(i) Denies the allegations contained in subparagraph (i) of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECG
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

EARL C. CROUTER,
E. A. TONJES,
Special Attorneys,
Bureau of Internal Revenue.

EAT/mm 12/20/44

Received and filed Dec. 28, 1944.

8 T. C. No. 144

The Tax Court of the United States

Docket No. 6415

Promulgated June 19, 1947

ANNIS VAN NUYS SCHWEPPE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

FINDINGS OF FACT AND OPINION

A corporation was indebted on a note in the amount of \$400,000 to petitioner's mother, a stockholder. The note was secured by a mortgage on the corporation's building. Interest was paid by the corporation on the note during the lifetime of the owner of it and it was carried on the books of the corporation as a bills payable due her. Petitioner's mother had expressed to certain members of the family her intention to never collect the principal of the debt but during her lifetime she made no formal cancellation of it and did nothing to indicate that she intended to make a contribution of the principal of the note to the capital of the corporation. Upon the mother's death the \$400,000 was transferred to a "Surplus Paid-In" account and subsequently the note was declared barred by the statute of limitations in a suit brought by the executor of the estate against the corporation. In 1940 and 1941 petitioner, a stockholder, received certain distributions from the corporation charged to "Reduction Surplus" account. Held, that peti-

tioner's mother did not gratuitously forgive the indebtedness of the corporation's note; held, further, that the distributions made to petitioner are dividends within the meaning of section 115 (a) of the Internal Revenue Code.

Sidney H. Wall, Esq., for the petitioner.

E. A. Tonjes, Esq., for the respondent.

This proceeding involves deficiencies in income tax for the calendar years 1940 and 1941 in the respective amounts of \$10,110.78 and \$20,605.75. The deficiencies are due to several adjustments to petitioner's net income as disclosed by her returns for the years 1940 and 1941. Petitioner contests three of these adjustments by appropriate assignments of error. In the stipulation filed herein one of the assignments of error was waived and one of the assignments of error was adjusted. Effect will be given to this stipulation in the recomputation under Rule 50. This leaves for our consideration only the contested adjustment for the years 1940 and 1941 which was explained by the respondent in a statement attached to the deficiency notice as follows:

The entire amounts distributed to you during the years 1940 and 1941 as a stockholder of the I. N. Van Nuys Building Company are determined to constitute taxable dividends under the provisions of section 115 of the Internal Revenue Code. Accordingly, dividend income from that source has been increased from \$10,746.62 to \$35,246.38 for 1940 and from \$3,128.02 to \$24,149.16 for 1941.

The sole issue, therefore, is whether the distributions made in the years 1940 and 1941 by the I. N. Van Nuys Building Company constituted "dividends" within the meaning of section 115 (a) of the Internal Revenue Code.

Findings of Fact

The petitioner is an individual residing in Los Angeles, California. Petitioner's income tax returns for the calendar years 1940 and 1941 were filed with the collector of internal revenue for the sixth district of California.

The I. N. Van Nuys Building Company, hereinafter sometimes referred to as the Building Company, was at all times material herein a corporation organized on or about February 15, 1911, and existing under the laws of the State of California. [18]

The petitioner is one of the three living children of I. N. Van Nuys and Susanna H. Van Nuys, both now deceased, the other children being Kate Van Nuys Page and J. B. Van Nuys. I. N. Van Nuys died on February 12, 1912, leaving a last will pursuant to which his entire estate, including the major portion of the shares of the Building Company, was transferred, one-half to his widow, Susanna H. Van Nuys, and one-sixth to each of his three children named above. The petition was during 1940 and 1941 the owner of approximately one-third of the outstanding capital stock of the Building Company. The stock of the Building Company has been at all times between January 1, 1913, and December 31, 1941, held by members of the

Van Nuys family, except for one qualifying share for a director which was held outside the family.

During 1940 and 1941 petitioner received upon the stock of the Building Company distributions in cash of \$35,246.38 and \$24,149.16, respectively.

The Building Company owns certain real property at the southwest corner of Seventh and Spring Streets, Los Angeles, California, up which is located the building commonly known as the Van Nuys Building. This building was constructed approximately in 1912 and 1913 by the Building Company and during the course of such construction Susanna H. Van Nuys loaned to the Company the sum of \$400,000 which loan was evidenced by a promissory note dated March 1, 1913, payable three years after its date with interest at five per cent. This note was secured by a mortgage dated March 1, 1913, on said real property which was never recorded.

In February, 1919, Susanna H. Van Nuys gave to her three children in equal shares all or substantially all of the property distributed to her from her husband's estate and still owned by her at the time. Such property included certain shares of stock of the Building Company. At about the same time she gave to her three children in equal shares the entire balance of shares of the Building Company owned by her independently of her husband's estate except one share which she retained until her death.

At about the time of the aforementioned gift in 1919 as well as before that time and as early as

1915 and as late as 1920 Susanna H. Van Nuys stated to various members of her family including her son, J. B. Van Nuys, who was then secretary of the Building Company, that she did not intend to enforce the collection of the note. She made no attempt during her lifetime to collect the note and it was not surrendered to the Building Company by her during her lifetime nor cancelled, nor the indebtedness represented thereby gratuitously forgiven by her.

Susanna H. Van Nuys died on May 1, 1923, leaving a will executed on October 27, 1920, disposing of her estate in which she made certain specific bequests of real and personal property and left the residue equally to her three children. Her will made no mention of the \$400,000 promissory note of the Building Company or the mortgage given to secure it.

Interest on the \$400,000 note was paid semi-annually to Susanna H. Van Nuys by the Building Company up to and including December 31, 1922, but no amount was ever paid on the principal and no interest was paid after December 31, 1922. Such interest payments were treated as expenses on the books of the Company and on its income tax returns. The Building Company was solvent at all times mentioned herein. The \$400,000 was carried on the books of the Building Company as a liability until January 21, 1924, when the amount was, pursuant to a resolution of the board of directors, transferred to "Surplus Paid-In" account. [20]

The "Inventory and Appraisement" filed on or about November 16, 1923, in the Superior Court of the State of California in the Matter of the Estate of Susanna H. Van Nuys, deceased, showed this \$400,000 note as being of no value, and the Federal estate tax return filed for the estate likewise reported the note as being of no value. In a letter dated September 17, 1925, the respondent advised The Title Insurance and Trust Company, the executor of the will of Susanna H. Van Nuys, of his tentative determination of a deficiency in the Federal estate tax upon this estate, based in part upon his tentative determination that said note should be included as an asset of the estate and should be valued at its face amount of \$400,000. On October 28, 1925, The Title Insurance and Trust Company commenced an action in the Superior Court of the State of California in and for the County of Los Angeles upon this promissory note and for foreclosure of the mortgage against the Building Company. In its answer thereto the Building Company pleaded the statute of limitations in effect in California. The cause was tried on November 4, 1925, before the court without a jury and the court found on November 6, 1925, that by reason of the failure of Susanna H. Van Nuys to institute an action to enforce the payment of this note and/or foreclose the mortgage securing the same within four years after the first day of March 1916, the date upon which the same matured, the said note and mortgage became barred by the statute of limita-

tions and the same were so barred at the time of the death of Susanna H. Van Nuys on May 1, 1923. The court after making its findings of fact stated its conclusions of law as follows: [21]

As a conclusion of Law from the foregoing facts, the court finds that the plaintiff is not entitled to judgment against the defendant; that the note and mortgage securing the same; and each of them is and are, barred by the statute of limitations, and were so barred at all times subsequent to March 1, 1920; that the plaintiff and its successors in interest are estopped and debarred from enforcing the same or assessing any claim or right by reason thereof; that by reason thereof the defendant is entitled to judgment here and it is ordered that judgment be entered accordingly.

A statement of protest, dated January 9, 1926, was filed on behalf of the executor of the estate of Susanna H. Van Nuys, in which protest was made among other things, against the tentative determination of the respondent that the \$400,000 note should be included as an asset of the estate. In a letter dated January 8, 1927, the respondent advised the executor of his determination of a deficiency in the Federal estate tax upon the estate again based in part upon his determination that the \$400,000 note should be included as an asset of said estate at its face amount. No action was taken by the executor before the Board of Tax Appeals with

respect to such notice of deficiency. On or about May 10, 1927, the executor paid to the collector of internal revenue of the sixth district of California, under protest, the amount of the deficiency asserted in said notice. On or about April 19, 1928, the executor commenced an action in the United States District Court for the Southern District of California, entitled Title Insurance & Trust Co. et al v. Welch, 37 Fed. (2d) 617 seeking a refund of a portion of the amount so paid. The court held in that action, among other things, that the \$400,000 note had no taxable market value for Federal estate tax purposes and should not be taxed in said estate, and entered its judgment on July 18, 1929, in favor of the executor for a refund of the amount of tax paid under protest with respect to said note. [22]

On September 13, 1938, the board of directors of the Building Company adopted three resolutions; the first increased the stated capital of the Company by the amount of \$400,000 theretofore transferred to "Surplus Paid-In" as set forth above, the second resolution authorized the reduction of the stated capital of the Company by the amount of \$400,000, and the third resolution authorized the distribution to the shareholders of the Company of the \$400,000 of reduction surplus resulting from the reduction of stated capital. All of the stockholders of the Building Company consented in writing to the reduction of the stated capital of the Company.

On September 13, 1938, pursuant to these resolutions, \$400,000 was transferred by appropriate entries on the books of the Company from "Surplus Paid-In" account to "Stated Capital" account and from "Stated Capital" account to "Reduction Surplus" account.

In the years prior to and including 1937 dividends paid to the stockholders of the Building Company were charged against "Earned Surplus" account. In 1938 and years thereafter the distributions made to stockholders were first charged against the "Earned Surplus" account until that account was exhausted and the balance was charged against "Reduction Surplus" account. The "Earned Surplus" account included all the earnings and profits of the Building Company which were available for distribution to its stockholders at the respective times of the distributions in the taxable years involved, except that respondent contends that the \$400,000 constituted additional earnings or profits, while petitioner contends that it did not constitute earnings or profits.

The total distributions made to petitioner in the taxable years by the Building Company and the accounts charged therefor are as follows: [23]

	Total Distributions Paid	Charged "Earned Surplus"	Charged "Reduction Surplus"
1940	\$35,246.38	\$10,746.62	\$24,499.76
1941	24,149.16	3,128.02	21,021.14

Only the portions of each of the above distributions in 1940 and 1941 which were charged to the "Earned Surplus" account on the books of the

Company were treated as taxable dividends by the petitioner in her income tax returns for those years. Respondent has included as taxable dividends and therefore as additional income to the petitioner for each of the taxable years the portions of these distributions which were charged to "Reduction Surplus" account on the books of the Company.

The stipulated facts are incorporated herein and made a part hereof.

Opinion

Black, Judge: As we have stated above the sole issue herein is whether certain distributions made by the Building Company in the years 1940 and 1941 constituted "dividends" within the meaning of section 115 (a) of the Internal Revenue Code.

Petitioner contends that Susanna H. Van Nuys during her lifetime and while she was a shareholder of the Building Company forgave the indebtedness of the Building Company as to the principal of the \$400,000 note; that this forgiveness of corporate indebtedness by a shareholder constituted a contribution to the capital of the Building Company; that capital so contributed does not constitute "earnings and profits" of the Building Company and that distributions out of such contributed capital to petitioner as a shareholder of the Building Company are not taxable dividends within the meaning of section 115 (a) of the Internal Revenue Code, but should be applied against and reduce the adjusted basis of the stock of the Building Company held by petitioner in accordance with sections

115 (d). The applicable portions of the [24] Internal Revenue Code are set out in the margin.¹

Respondent concedes that if petitioner's premise were sound, namely, that Susanna H. Van Nuy's in her lifetime forgave the indebtedness of \$400,000 to the Building Company and made a contribution of that amount to its capital surplus, then such \$400,000 would not constitute a fund from which taxable dividends could be paid. Respondent contends, however, that such was not the case but that

¹Sec. 115. Distributions by Corporations.

(a) Definition of Dividend—The term "dividend" when used in this chapter (except in section 203(a)(3) and section 207(c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. * * *

* * * * *

(d) Other Distributions From Capital—If any distribution by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. This subsection shall not apply to a distribution in partial or complete liquidation or to a distribution which, under subsection (f)(1), is not treated as a dividend, whether or not otherwise a dividend. [25]

the way the Building Company secured freedom from payment of the note was to plead the statute of limitations in a suit brought by the executor of Susanna H. Van Nuys after her death; and that the Building Company's success in having this plea sustained by the court at a time when the corporation was thoroughly solvent resulted in increasing its earnings and profits by the sum of \$400,000.

Respondent therefore contends that the entire distribution of \$35,246.38 and \$24,149.16 paid to petitioner during the years 1940 and 1941, respectively, by the Building Company were paid out of "earnings and profits accumulated after February 28, 1913," and constitute taxable dividends within the meaning of section 115(a), *supra*.

The courts and Treasury Regulations² have long recognized that a gratuitous forgiveness by a stockholder of a debt of his corporation may amount to a capital contribution. See *Carroll-McCreary Co., Inc. v. Commissioner*, 124 Fed (2d) 303; *Amer-*

²Regulations 103.

Sec. 19.22(a) - 14. Cancellation of indebtedness —(a) In general—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See section 19.22(a)-18.) In general, if a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation to the extent of the principal of the debt. [26]

ican Cigar Co. v. Commissioner, 66 Fed. (2d) 425; Commissioner v. Auto Strop Safety Razor Co., 74 Fed. (2d) 226. Respondent maintains that the facts herein do not permit application of the above doctrine.

The problem here is largely one of fact. The question turns upon whether Susanna H. Van Nuys, a stockholder of the Building Company, forgave the indebtedness of the Building Company as to the principal of the \$400,000 note so as to amount to a capital contribution.

We agree with respondent's contention that the evidence herein does not establish that Susanna H. Van Nuys forgave the indebtedness of the Building Company as to the note herein so as to amount to a capital contribution. The evidence shows that during the lifetime of Susanna H. Van Nuys the Building Company continued to pay her interest on the note and carried the note on its books as an obligation which it owed her. It may have been the intent of Susanna H. Van Nuys to never collect the principal of the note, as she indicated at various times in conversations with members of her family, but this falls short of the proof required to establish that payment thereof was forgiven, so as to amount to a capital contribution. No action was taken either by Susanna H. Van Nuys or by the corporation to indicate that the debt had been forgiven. There was no record made, no resolution adopted, nor other action taken consistent with the thought that the indebtedness was forgiven. As we

have already said the note was carried on the books of the Building Company as a liability during her lifetime and she continued to receive payment of the interest. The very fact that interest was paid by the corporation each year on the note to Mrs. Van Nuys and that the corporation continued to carry it upon its books as bills payable shows that she had not in fact forgiven the indebtedness and had not made a capital contribution of it to the corporation. We think it is also significant that in February 1919 when she gave to her three children, including the petitioner, all of the stock of the Building Company owned by her, except one share, nothing was done to show that the payment of the note was to be forgiven so as to vest in the children complete ownership of the Building Company freed from the obligation of the debt. Moreover when the executor of the estate of Susanna H. Van Nuys brought an action on the note in the California court and the Building Company pleaded only the statute of limitations as a defense we think it indicated that the parties believed in [27] the existence of the debt. There was no claim in that suit that Mrs. Van Nuys had forgiven the indebtedness to the Building Company during her lifetime.

Petitioner relies upon *American Cigar Co. v. Commissioner*, *supra*, in support of her contention that a contribution to the capital of a corporation may be made by one of its shareholders by means of a loan to the corporation which the shareholder

does not expect or intend to collect, even though the shareholder holds promissory notes of the corporation evidencing the debt which have never been surrendered or cancelled in any way. The instant case is distinguishable on its facts from that case. In the American Cigar Co. case the taxpayer held bonds and stock of another corporation which was in a poor financial condition and was unable to pay interest on its bonds. The taxpayer was reluctant to allow the debtor corporation to go into receivership and advanced money to enable it to meet its operating expenses and pay interest on its bonds. The taxpayer made the advances firmly believing that the obligations were worthless and uncollectible and were advanced in the belief they would never be repaid. The Second Circuit held that such advances made in the belief that they would not be repaid were in the nature of gifts and contributions to the capital of the debtor corporation. The Building Company herein was solvent during the entire period and there is no evidence whatever that the loan was made in the belief that the amount would not be repaid.

Having found that Susanna H. Van Nuys did not make a contribution to the capital of the Building Company, was the \$400,000 "earnings and profits" within the meaning of section 115 (a) of the Internal Revenue Code? We think it was. In fact we do not understand that petitioner contends to [28] the contrary, if we fail to sustain her contention that Susanna H. Van Nuys forgave the note to the

corporation in her lifetime. When the corporation was relieved of the debt of \$400,000 its free assets were correspondingly increased. This enhancement was due to the judgment of the California court in the suit on the note brought by the executor of the estate of Susanna H. Van Nuys wherein the court upheld the contention of the Building Company that the statute of limitations in effect in California was a bar. It was not until the judgment of the California court that the right of the noteholder was finally determined because the only defense to the payment of the note was the plea of the bar of the statute of limitations which must be affirmatively pleaded and could have been waived. Since the note was barred by the statute of limitations it was not a gratuitous cancellation so as to amount to a gift within the rationale of *Helvering v. American Dental Co.*, 318 U.S. 322. By virtue of the judgment of the California court the amount of \$400,000 was released to the general uses of the Building Company and its assets, previously offset by the obligation of the note, were made available to the Building Company. This benefit, we think, is "earnings and profits" within the meaning of section 115(a). Cf. *U. S. v. Kirby Lumber Co.*, 284 U.S. 1; *Helvering v. American Chicle Co.*, 291 U.S. 426; *Walker v. Commissioner*, 88 Fed. (2d) 170, certiorari denied 302 U.S. 692; *B. F. Avery & Sons, Inc.*, 26 B.T.A. 1393, petition for review dismissed 67 Fed. (2d) 985; *Lutz & Schramm Co.*, 1 T.C. 682; *R. O'Dell & Sons Company, Inc.*, 8 T.C. (promulgated June 9, 1947.) [29]

Petitioner argues that it was not the date of the judgment of the Superior Court of California to the effect that the note was barred by the statute of limitations that is the determinative date. Petitioner argues that inasmuch as the note was barred on March 1, 1920, it was unenforceable from that date. Therefore, contends petitioner, March 1, 1920, is the pivotal date even if respondent's view be accepted. We do not see where that makes any difference. If March 1, 1920, be accepted as the date when the note became unenforceable and petitioner's assets became freed from its payment to the extent of \$400,000, the result is the same so far as we can see.

We hold, therefore, that the distributions herein made to petitioner are dividends within the meaning of section 115 (a) of the Internal Revenue Code.

Decision will be entered under Rule 50.

[Seal] [30]

The Tax Court of the United States

Docket No. 6415

ANNIS VAN NUYS SCHWEPPE,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of this Court as set forth in its Findings of Fact and Opinion promulgated June 19, 1947, the respondent herein filed a proposed recomputation on August 7, 1947, to which petitioner filed her acquiescence August 26, 1947, now therefore, it is

Ordered and Decided that there are deficiencies in income tax for the calendar years 1940 and 1941 in the respective amounts of \$10,110.78 and \$14,850.00.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered Aug. 28, 1947 [31]

[Title of Tax Court and Cause.]

PETITION OF TAXPAYER FOR REVIEW
BY THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE NINTH
CIRCUIT, OF A DECISION BY THE TAX
COURT OF THE UNITED STATES

Taxpayer, the petitioner in this case, by Elmo H. Conley and Bert A. Lewis, her Counsel, hereby files her petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision by The Tax Court of the United States, promulgated June 19, 1947, reported in 8 T.C. 1224, and rendered August 28, 1947, determining deficiencies in the petitioner's Federal Income Taxes for the calendar years 1940 and 1941 in the respective amounts of \$10,110.78 and \$14,850. [32]

I.

The petitioner is a resident of Los Angeles, Los Angeles County, California, and was a resident of said City and County at all times during the tax years here involved and at all times subsequent thereto. The income tax returns of the petitioner for the years here involved were filed with the collector's office at Los Angeles, California.

II.

Nature of the Controversy

The controversy involves the proper determination of the petitioner's liability for Federal Income

Tax for the calendar years 1940 and 1941. There is but one question at issue in each of these years and that question is the same for each year. It involves the interpretation of Section 115(a) of the Internal Revenue Code.

During these years taxpayer, as a stockholder in the I. N. Van Nuys Building Company, received cash distributions from said Company with respect to her stock in amounts totalling \$35,246.38 for the calendar year 1940 and \$24,149.16 for the calendar year 1941. It is conceded that of these amounts \$10,746.62 for the year 1940, and \$3,128.02 for the year 1941 were paid out of the "earnings or profits" of said Company, and are taxable as dividend income under Section 115(a) of the Internal Revenue Code. The Commissioner contends that the balance of such distributions was likewise paid out of earnings or profits and is, therefore, taxable as a dividend in each of the years involved, whereas the taxpayer claims [33] that there were no further earnings or profits available to cover said balance and that, therefore, it is not taxable as a dividend but should be applied in reduction of the basis of her stock in said Company.

It is conceded by both parties that the issue thus raised depends upon whether or not an increase in the net assets of said Company in the amount of \$400,000, resulting from the elimination as a liability of the Company of an original indebtedness of that amount to Suzanna H. Van Nuys, taxpayer's mother, constitutes "earnings or profits" of said Company.

Suzanna H. Van Nuys loaned \$400,000 to said Company in 1913 and took its promissory note payable three years after date with interest at 5%. She then owned one-half of the stock in said Company and her three children, of whom petitioner is one, owned the other half. Nothing was done concerning payment when the note matured in 1916, and at various times between 1915 and 1920 she told her children she never intended to enforce collection of the note. In 1919 she gave them all of her stock in the building company except one share, and they, or their families, have owned all of it ever since.

In May, 1923, Mrs. Suzanna H. Van Nuys died still possessing the note upon which interest had been paid through 1922, and leaving a will which mentioned specifically many assets but made no mention of the note. When the question [34] was raised regarding the taxability of the note as an asset in her estate, an action was brought by the Company against the Executor on the note. The Executor successfully pleaded the Statute of Limitations and secured judgment.

Meanwhile, in January 1924, prior to the commencement of the suit to enforce the note, the Company eliminated its liability on the note and transferred the amount to "paid-in surplus." Petitioner maintains that the reflection of this credit as a capital surplus item rather than as "earnings or profits" was and is proper for Federal Income Tax purposes, while the Commissioner claims that it should have been and should be reflected as an "earning or profit."

All of the facts affecting this legal issue are clearly set forth in the findings of fact in the Tax Court opinion and are not in dispute.

III.

The petitioner, being aggrieved by the conclusions of law contained in the Tax Court's opinion and by its decision entered pursuant thereto, desires to obtain a review thereof by the Circuit Court of Appeals for the Ninth Circuit.

IV.

Assignments of Error

The petitioner assigns as error the following conclusions of law of the Tax Court: [35]

1. The finding that the entire distributions received by petitioner from the aforesaid Company in 1940 and 1941 constituted dividend income.

2. The finding that the earnings or profits of said Company properly allocable to the distributions to the petitioner for the year 1940 exceeded \$10,746.62, and for the year 1941 exceeded \$3,128.02.

3. The finding that the elimination of the aforesaid \$400,000 indebtedness by said Company increased its earnings or profits by \$400,000.

4. The finding of deficiencies for the years 1940 and 1941 in the respective amounts of \$10,110.70 and \$14,850 in lieu of a determination that the defi-

ciencies for said years should be respectively \$750.88 and \$4,500.15.

/s/ ELMO H. CONLEY,

/s/ BERT A. LEWIS,

Counsel for Petitioner.

State of California,

County of Los Angeles—ss.

Elmo H. Conley and Bert A. Lewis, each being first duly sworn, says that he is Counsel of record in the above named case; that, as such counsel, he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements contained therein; and that the statements are true to the best of his knowledge, information and belief.

ELMO H. CONLEY

BERT A. LEWIS

Subscribed and sworn to before me this 7th day of November, 1947.

[Notarial Seal] FERN E. WORMAN,
Notary Public in and for the County of Los Angeles.

My Commission Expires June 7, 1949.

Filed Nov. 14, 1947. [37]

[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Charles Oliphant, Acting Counsel, Bureau of
Internal Revenue, Washington, D. C.

Please take notice that the petition on the 14th day of November, 1947, filed with the Clerk of the Tax Court of the United States at Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit, of a decision by the Tax Court of the United States, heretofore rendered in the above entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you. Dated this 18th day of November, 1947, at Los Angeles, California.

Respectfully,

/s/ ELMO H. CONLEY,

/s/ BERT A. LEWIS,

Counsel for Petitioner.

Personal service of the foregoing Notice together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 20th day of November, 1947.

/s/ CHARLES OLIPHANT, CAR

Chief Counsel,

Bureau of Internal Revenue,
Counsel for Respondent.

Filed Nov. 20, 1947. [39]

In the Tax Court of the United States

Docket No. 6415

ANNIS VAN NUYS SCHWEPPE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION

The parties hereto by their undersigned counsel of record hereby stipulate and agree that the following facts shall be taken as proved in the above mentioned appeal upon the filing of this stipulation, subject to the right of either party to introduce other and further evidence not inconsistent with the terms of this stipulation.

1. The petitioner is now and at all times material herein was an individual residing in Los Angeles, California, and having an office at 210 West Seventh Street in that city. Petitioner's income tax returns for the calendar years 1940 and 1941 (the taxable years here in controversy) were filed with the Collector of Internal Revenue for the Sixth District of California.

2. The respondent determined deficiencies in the petitioner's income tax and set forth his determination by [40] notice dated August 10, 1944, a copy of which is attached to the petition herein and by this reference is made a part hereof.

3. The petitioner waives the assignment of error with respect to disallowance of depreciation contained in subparagraph (b) of paragraph 4 of the petition.

4. The correct amount of "capital gain adjustments" to net income for the year ended December 31, 1941, is \$9,611.56 in lieu of the sum of \$28,797.40 in the notice of deficiency under the caption "(c) Capital gain adjustments \$28,797.40." This adjustment relates to the assignment of error in subparagraph (c) of paragraph 4 of the petition.

5. The sole issue in this proceeding is whether or not certain distributions made in the years 1940 and 1941 by I. N. Van Nuys Building Company constituted "dividends" within the meaning of Section 115 (a) of the Internal Revenue Code. This issue is raised by subparagraph (a) of paragraph 4 of the petition.

6. The I. N. Van Nuys Building Company was at all times material herein a corporation organized and existing under the laws of the State of California, having been organized on or about February 15, 1911.

7. The petitioner was at all times during the years [41] 1940 and 1941 the owner of approximately one-third of the outstanding capital stock of the I. N. Van Nuys Building Company. At all times between January 1, 1913 and December 31, 1941, the stock of said company was held of record as set forth in the schedule attached hereto, marked Exhibit 1-A, and made a part hereof.

8. In the years 1940 and 1941 petitioner received upon said stock of the I. N. Van Nuys Building Company distributions in cash of \$35,246.38 and \$24,149.16, respectively.

9. The petitioner is one of the three living children of I. N. Van Nuys and Susanna H. Van Nuys (both now deceased), the other children being Kate Van Nuys Page and J. B. Van Nuys.

10. I. N. Van Nuys died on February 12, 1912, leaving a will pursuant to which his entire estate, including the major portion of the shares of said I. N. Van Nuys Building Company, was transferred, one-half to his widow, Susanna H. Van Nuys and one-sixth to each of his three children named above.

11. The I. N. Van Nuys Building Company owns and at all times herein mentioned has owned certain real property at the southwest corner of Seventh and Spring Streets, Los Angeles, California, upon which is located the building commonly known as the Van Nuys Building. Said building was constructed approximately in 1912 and 1913 by said company [42] and during the course of such construction Susanna H. Van Nuys loaned to said company the sum of \$400,000 (out of her separate property held by her before the death of I. N. Van Nuys), which loan was evidenced by a promissory note, a copy of which is attached hereto, marked Exhibit 2-B, and made a part hereof.

12. Said note for \$400,000 was secured by a mortgage on said real property, which mortgage was never recorded.

13. In February, 1919, Susanna H. Van Nuys gave to her said three children in equal shares all or substantially all the property distributed to her from her husband's estate and still owned by her at the time. Such property included certain shares of said I. N. Van Nuys Building Company. At about the same time she gave to her said three children in equal shares the entire balance of shares of said company owned by her, except one share which she retained until her death.

14. Susanna H. Van Nuys died on May 1, 1923, leaving a will executed on October 27, 1920, disposing of her estate generally as follows:

Specifically described real property was devised to each of her children separately;

An undivided one-third interest in certain other real property, in a certain trust estate, and in a certain mortgage (not that securing said \$400,000 note) as devised to each of her children; [43]

Certain bank stock was bequeathed to each of her children;

Certain small specific bequests were made; and

The residue was left equally to her said three children.

Neither said \$400,000 promissory note nor said mortgage was mentioned in her will.

15. Interest on said \$400,000 note was paid semi-annually to Susanna H. Van Nuys by said I. N. Van Nuys Building Company up to and including December 31, 1922, but no amount was ever paid on the principal, and no interest was paid after December 31, 1922. Such interest payments were treated as expenses on the books of said company and on its income tax returns. Said company was solvent at all times herein mentioned. The said \$400,000 was carried on the books of I. N. Van Nuys Building Company as a liability until January 21, 1924, when the amount was, pursuant to a resolution of the board of directors, transferred to "Surplus Paid-In" account.

16. The "Inventory and Appraisement" filed on or about November 16, 1923, in the Superior Court of the State of California in the Matter of the Estate of Susanna H. Van Nuys, deceased, showed said \$400,000 note as being of no value; and the Federal Estate Tax Return filed for said estate likewise reported said note as being of no value. In a letter dated September 17, 1925, the Commissioner of Internal Revenue advised Title Insurance and Trust Company, the executor of the will of Susanna H. Van Nuys, of his tentative determination of a deficiency in the Federal Estate Tax upon said estate, based in part upon his tentative determination that said note should be included as an asset of said estate and should be valued at its face amount of \$400,000.

17. On October 28, 1925, Title Insurance and Trust Company, the executor of the will of Susanna

H. Van Nuys, commenced an action in the Superior Court of the State of California in and for the County of Los Angeles, upon said prommisory note and mortgage against the I. N. Van Nuys Building Company. A copy of the judgment roll in said action, consisting of the complaint, answer, findings of fact and conclusions of law, and judgment, is attached hereto, marked Exhibit 3-C, and made a part hereof.

18. A statement of protest, dated January 9, 1926, was filed on behalf of said executor of the estate of Susanna H. Van Nuys, in which protest was made among other things, against the tentative determination of said Commissioner that said \$400,000 note should be included as an asset of said estate, and to which were attached as exhibits copies of the findings of fact and conclusions of law and of the judgment [45] in said action referred to in paragraph 17 above. In a letter dated January 8, 1927, the Commissioner of Internal Revenue advised said executor of his determination of a deficiency in the Federal Estate Tax upon said estate, again based in part upon his determination that said \$400,000 note should be included as an asset of said estate at its face amount. No action was taken by said executor before the Board of Tax Appeals with respect to such notice of deficiency. On or about May 10, 1927, said executor paid to the Collector of Internal Revenue for the Sixth District of California, under protest, the amount of the deficiency asserted in said notice. After a partial re-

jection of a claim for refund filed by said executor, and on or about April 19, 1928 said executor commenced an action in the United States District Court for the Southern District of California, entitled Title Insurance and Trust Co., et al. v. Welch, Collector of Internal Revenue (No. 3150-M), seeking a refund of a portion of the amount so paid. Said court held in that action, among other things, that said \$400,000 note had no taxable market value for federal estate tax purposes and should not be taxed in said estate; and said court entered its judgment in said action on July 18, 1929, in favor of said executor for a refund, inter alia, of the amount of tax paid under protest with respect to said note.

19. On September 13, 1938, the board of directors of said I. N. Van Nuys Building Company unanimously adopted [46] three certain resolutions, the first of which increased the stated capital of said company by said amount of \$400,000 theretofore transferred to "Surplus Paid-In" as set forth in paragraph 15 above (a copy of said resolution being attached hereto as Exhibit 4-D), the second of which authorized the reduction of the stated capital of said company by said amount of \$400,000 (a copy of said resolution being attached hereto as Exhibit 5-E), and the third of which authorized the distribution to the shareholders of said company of the \$400,000 of reduction surplus resulting from said reduction of stated capital (a copy of said resolution being attached hereto as Exhibit 6-F).

20. All of the stockholders of the said I. N. Van Nuys Building Company consented in writing to the reduction of the stated capital of said company in accordance with the resolution referred to in paragraph 19 above.

21. On September 13, 1938, pursuant to said resolutions, \$400,000 was transferred by appropriate entries on the books of said I. N. Van Nuys Building Company from "Surplus Paid-In" account to "Stated Capital" account and from "Stated Capital" account to "Reduction Surplus" account.

22. In all the years prior to and including 1937 dividends paid to the stockholders of I. N. Van Nuys Building Company were charged against "Earned Surplus" account. In 1938 and years thereafter the distributions made to stockholders were first charged against said "Earned Surplus" account until that account was exhausted and the balance was charged against "Reduction Surplus" account. Said "Earned Surplus" account included all the earnings and profits of said company which were available for distribution to its stockholders at the respective times of the distributions in the taxable years involved, except that respondent contends that the said \$400,000 (which was credited to said "Reduction Surplus" account and the status of which is here in issue) constituted additional earnings or profits, while, petitioner contends that it did not constitute earnings or profits.

23. The total distributions made to petitioner by said I. N. Van Nuys Building Company and the accounts charged therefor are as follows:

	Total Distributions Paid	Charged “Earned Surplus”	Charged “Reduction Surplus”
1940	\$35,246.38	\$10,746.62	\$24,499.76
1941	24,149.16	3,128.02	21,021.14

The distributions made out of and charged to “Reduction Surplus” are those in issue in this proceeding as stated in paragraph 5 above.

MAYNARD J. TOLL and
SIDNEY H. WALL,

By /s/ SIDNEY H. WALL,
Counsel for Petitioner.

/s/ J. P. WENCHEL, ECC
Chief Counsel, Bureau of
Internal Revenue. [48]

EXHIBIT 1-A

Record Ownership of Stock

In I. N. Van Nuys Building Company, June 26, 1913, to December 31, 1941

	1-1-13 to 6-25-13	6-26-13 to 7-9-13	7-9-13 to 12-31-13	12-31-13 to 2-27-19	2-27-19 to 9-28-23	9-28-23 to 12-6-27	12-6-27 to 12-13-41	12-13-41 to 12-31-41
Estate of I. N. Van Nuys..12750								
Susanna H. Van Nuys...	99	6574	7499	6574	1*	1*		
J. B. Van Nuys or wife or Van Nuys Invest- ment Company.....	100	2191 $\frac{2}{3}$	2500	2191 $\frac{2}{3}$	4382 $\frac{2}{3}$	4382 $\frac{2}{3}$	4383	4383
Kate Van Nuys Page or Husband	100	2191 $\frac{2}{3}$	2500	2191 $\frac{2}{3}$	4382 $\frac{2}{3}$	4382 $\frac{2}{3}$	4383	4383
Annis Van Nuys Schweppe	100	2191 $\frac{2}{3}$	2500	2191 $\frac{2}{3}$	4382 $\frac{2}{3}$	4372 $\frac{2}{3}$	4373	4383
R. J. Schweppe (husband of Annis Van Nuys Schweppe)						10	10	
H. W. or John O'Melveny	1	1	1	1	1	1	1	1

*Held in Estate of Susanna H. Van Nuys after her death on May 1, 1923.

EXHIBIT 2-B

\$400,000.00

Los Angeles, California, March 1, 1913.

Three years after date, for value received, I. N. Van Nuys Building Company promises to pay to Susanna H. Van Nuys at Los Angeles, California, the sum of Four Hundred Thousand Dollars, with interest from date until paid, at the rate of Five (5) per cent per annum, payable quarterly; should the interest not be so paid, it shall become part of the principal and thereafter bear like interest as the principal. Should default be made in the payment of any installment of interest when due, then the whole sum of principal and interest shall become immediately due and payable at the option of the holder of this note. Principal and interest payable in gold coin of the United States. This note is secured by a mortgage upon real property.

[Seal]

I. N. VAN NUYS BUILDING
COMPANY,By ANNIS VAN NUYS,
Vice-President.By J. B. VAN NUYS,
Secretary.

In the Superior Court of Los Angeles County,
State of California

182011

TITLE INSURANCE & TRUST COMPANY, a
Corporation, Executor of the Last Will and
Testament of Susanna H. Van Nuys, deceased,
Plaintiff,

vs.

I. N. VAN NUYS BUILDING COMPANY, a
Corporation,
Defendant.

COMPLAINT

FORECLOSURE OF MORTGAGE

Comes now the plaintiff in the above entitled action, and for cause of action against the defendant complains and alleges as follows, to wit:

I.

That the defendant is now, and was, at all times hereinafter mentioned, a corporation, organized and existing under and by virtue of the laws of the State of California, with its principal place of business in the City of Los Angeles, County of Los Angeles, State of California.

II.

That on or about the 1st day of March, 1913, at

Los Angeles, in the County of Los Angeles, State of California, the defendant executed and delivered to Susanna H. Van Nuys its promissory note in words and figures as follows, to wit:

“\$400,000.00

Los Angeles, California, March 1, 1913

Three years after date, for value received, I. N. Van Nuys Building Company promise to pay to Susanna H. Van Nuys or order, at Los Angeles, California the sum of Four Hundred Thousand Dollars, with interest thereon from date until paid, at the rate of Five (5) per cent per annum, payable quarterly; Should interest not be so paid, it shall become part of the principal and thereafter bear like interest therewith. Should default be made in payment of interest when due, the whole sum of principal and interest shall, at the option of the holder of this note, become immediately due. Principal and interest payable [51] in United States gold coin. This note is secured by a mortgage upon real property.

I. N. VAN NUYS BUILDING
COMPANY,

By ANNIS VAN NUYS,
Vice-President,

By J. B. VAN NUYS,
Secretary.”

III.

That to secure the payment of said principal sum and interest thereon as mentioned, set forth and provided in said note and mortgage, and the various other sums agreed to be paid under the terms of said mortgage and note, the defendant, at the same time and place aforesaid, made, executed and delivered to the said Susanna H. Van Nuys a certain mortgage bearing date the said 1st day of March, 1913, which was duly acknowledged, and a copy of which is attached hereto, marked "Exhibit A," and made a part hereof as fully and to the same extent as if set forth at length herein.

IV.

That the interest on said principal sum mentioned in said promissory note and mortgage has been paid to and including the 31st day of December, 1922, and that no other sum or sums has or have been paid on said note or mortgage, either on account of interest, principal or otherwise; that the principal sum set forth in said promissory note and mortgage and interest thereon at the rate of Five (5%) per cent per annum, compounded quarterly from January 1, 1923, has not been paid.

V.

That plaintiff has incurred a liability to pay an attorney's fee in a reasonable sum to be fixed by the Court for the foreclosure of this mortgage.

VI.

That the said Susanna H. Van Nuys during her life time made and published her last Will and Testament, wherein she appointed [52] the plaintiff executor thereof.

VII.

That the said Susanna H. Van Nuys died on or about the 1st day of May, 1923 in the County of Los Angeles, State of California, and on the 5th day of June, 1923, the last Will and Testament of said decedent was proved and admitted to probate in the Superior Court of Los Angeles County, State of California, and plaintiff appointed executor thereunder; that thereupon Letters Testamentary were issued to the plaintiff, which ever since has been, and now is, the duly appointed, qualified and acting executor of the Estate of Susanna H. Van Nuys, deceased.

Wherefore, the plaintiff prays judgment against the said defendant:

1. For the sum of Four Hundred Thousand (\$400,000.00) Dollars, with interest thereon at the rate of Five (5%) per cent per annum from the 1st day of January, 1923, and for costs of suit.
2. That the usual decree may be made for the sale of said premises by the Sheriff of said county, according to law and the practice of this court; that the proceeds of said sale may be applied in payment of the amount due to

the plaintiff, and that said defendant and all persons claiming under it, subsequent to the execution of said mortgage upon said premises, either as purchasers, incumbrancers, or otherwise, may be barred and foreclosed of all rights, claim, or equity of redemption in the said premises, and every part thereof, and that the said plaintiff may have judgment, and execution against the said defendant for any deficiency which may remain after applying all the proceeds of the sale of said premises properly applicable to the satisfaction of said judgment.

3. That the plaintiff may become a purchaser at said sale; that the sheriff execute a deed to the purchaser; that the said purchaser be let into the possession of the premises on production of the sheriff's deed therefor; and that the plaintiff may have such other or further relief in the premises as to this court may seem meet and equitable.

/s/ HARRY A. CHAMBERLIN,
Attorney for Plaintiff. [53]

State of California,
County of Los Angeles—ss.

W. W. Powell being duly sworn, deposes and says:

That the plaintiff in the above entitled action is a corporation; that he is an officer thereof; to wit: Trust Officer; that he has read the foregoing com-

plaint and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters that he believes it to be true.

/s/ W. W. POWELL.

Subscribed and sworn to before me this 28th day of October, 1925.

/s/ B. S. CHAMBERLIN,
Notary Public in and for the County of Los Angeles, State of California. [54]

“EXHIBIT A”

This Mortgage, Made the First day of March, 1913, By I. N. Van Nuys Building Company, a corporation organized under the laws of the State of California, and having its principal place of business in the City of Los Angeles, Calif., Mortgagor, To Susanna H. Van Nuys, Mortgagee,

Witnesseth: That the Mortgagor hereby mortgages to the Mortgagee all that real property in the City of Los Angeles, County of Los Angeles, State of California, described as follows:

Part of Lots Four (4) and Five (5) in Block twenty-four (24) of Ord's Survey, in the City of Los Angeles, County of Los Angeles, State of California, described as follows:

Beginning at the intersection of the present southerly line of Seventh Street with the Westerly line of Spring Street; thence westerly

along said line of Seventh Street 155.56 feet to the Easterly line of the alley running northerly and southerly through said block; thence southerly along said easterly line 170.72 feet to the Northerly line of the lot now or formerly owned by M. A. Newmark, thence easterly along said Northerly line 155.31 feet to the Westerly line of Spring Street; thence along the same northerly 170.25 feet to the point of beginning.

including all buildings or improvements thereon or that may be erected thereon, together with all and singular the tenements, hereditaments and appurtenances, water and water rights, pipes, flumes and ditches thereunto belonging or in anywise appertaining and the reversion and reversions, remainder and remainders, rents, issues and profits thereof; or for the purpose of securing

First: Performance of the promises and obligations of this mortgage and payment of the indebtedness evidence by a promissory note (and any renewal or extension thereof) in words and figures as follows:

\$400,000.00

Los Angeles, California, March 1, 1913.

Three years after date, for value received, I. N. Van Nuys Building Company promises to pay to Susanna H. Van Nuys or order at Los Angeles, California, the sum of Four Hundred Thousand Dollars, with interest from date until paid, at the

rate of Five (5) per cent per annum, payable quarterly; Should the interest not be so paid, it shall become part of the principal and thereafter bear like interest as the principal. Should default be made in the payment of any installment of interest when due, then the whole sum of principal and interest shall become immediately due and payable at the option of the holder of this note. Principal and interest payable in gold coin of the United States. This note is secured by a mortgage upon real property.

[Corporate Seal]

I. N. VAN NUYS BUILDING
COMPANY,

By.....,
Vice President.

By.....,
Secretary.

Second: Payment of attorney's fees, in a reasonable sum to be fixed by the Court, in any action brought to foreclose this mortgage or in any action, suit or proceeding affecting the rights of the mortgagee herein, whether brought by or against the owner of said real property, involving either the title thereto, the lien of this mortgage thereon, the validity or priority of such lien, or the rights of the mortgagee hereunder, whether such action, suit, or proceeding progress to judgment or not; also

payment of all costs and expenses of such suit, and such sums as said mortgagee may pay for searching the title to the mortgaged property subsequent to the date of the record of this mortgage or for surveying said property, all of which sums, including said attorney's fees, the mortgagor agrees to pay, and the same are hereby declared a lien upon said property and are secured hereby.

Third: Payment of all sums expended or advanced by the mortgagee for taxes, assessments, incumbrances, adverse claims, fire insurance, inspection, repair, cultivation, irrigation, protection, fertilization, fumigation or any other expenditure in connection with the care or maintenance of said property or for any other purpose provided for by the terms of this mortgage, the mortgagee being hereby made sole judge of the necessity of any such expenditures.

Fourth: The mortgagor agrees to pay, as soon as due, all taxes, assessments and incumbrances, which may be, or appear to be, liens upon said property or any part thereof, including taxes, if any are levied or assessed under the laws of the State of California upon this mortgage or upon the debt secured hereby, and hereby waives all right to treat the payment of such taxes or assessments as a payment on the debt hereby secured or as being to any extent a discharge thereof; and the mortgagor agrees to keep said buildings insured against fire, to the amount required by and in such insurance companies as may be satisfactory to the

mortgagee, and to assign the policies therefor to the mortgagee; and promptly to pay [56] and settle (or cause to be removed by suit or otherwise) all adverse claims against said property.

Fifth: In case said taxes, assessments, or incumbrances so agreed to be paid by the mortgagor be not so paid, or said buildings so insured and said policies so assigned, or said adverse claims so paid, settled or removed, then the mortgagee, being hereby made sole judge of the legality thereof, may, without notice to the mortgagor, pay such taxes, assessments or incumbrances, obtain such policies of insurance and pay or settle any or all such adverse claims or cause the same to be removed by suit or otherwise.

Sixth: In the event of a loss under said policies of fire insurance, the amount collected thereon shall be credited first to interest due, if any, upon said indebtedness, then upon any advances secured hereby, and the remainder, if any, may, at the option of the mortgagee, be applied and credited upon said principal sum; or, at the option of the mortgagee, said remainder may be released to the mortgagor for the purpose of making repairs or improvements upon said property, and in that event the mortgagee shall not be obliged to see to the application of the sums so released nor shall said remainder be deemed a payment of any of the indebtedness secured hereby.

Seventh: The mortgagor agrees to keep said property in good condition and repair and to permit no waste thereof, and should said property, or any part thereof, require any inspection, repair, cultivation, irrigation, protection, care or attention of any kind or nature, other than that provided by the Mortgagor, then the mortgagee, being hereby made sole judge of the necessity therefor, and without notice to the mortgagor, may enter, or cause entry to be made, upon said property, and inspect, repair, cultivate, irrigate, fertilize, fumigate, protect, care for, or maintain, said property as said mortgagee may deem necessary. All sums expended by the mortgagee in doing any of the things in this mortgage authorized are hereby secured and shall be paid to the mortgagee by the [57] mortgagor in said gold coin, on demand, together with interest from date of payment, at the same rate of interest as is provided to be paid in the note hereinbefore set out.

Eighth: In consideration of said loan made by said mortgagee, the mortgagor waives all right either to apply for, or to procure, registration of said land or any part thereof under the provisions of an Act adopted November 3, 1914, known as the "Land Title Law," and hereby agrees:

(a) That to bring said land or any part thereof under the operation of said Act would impair the security of this obligation;

(b) That said mortgagor will not cause or permit any part of said land to be brought under the operation of said Act;

(c) That if, at any time, the owner of any part of said property shall file a petition for that purpose, or in the event that any part of said property be registered under the provisions of said Act, the filing of such petition for registration, or such registration, shall each constitute a default in the performance of the covenants and agreements herein contained on the part of the mortgagor, and the whole sum of money secured by this mortgage shall become immediately due and payable at the option of the holder of said note, and the mortgagee may proceed to foreclose this mortgage in accordance with the terms and provisions of paragraphs Ninth and Tenth below.

Ninth: The mortgagor promises to pay said note according to the terms and conditions thereof, and in case of default in payment of the same, or of any installment of interest thereon when due, or if default be made in payment of any other of the moneys herein agreed to be paid, or in the performance of any of the covenants and agreements herein contained on the part of the mortgagor, the whole sum of money then secured by this mortgage shall become immediately due and payable at the option of the holder of said note, and this mortgage may thereupon, or at any time during such default, be foreclosed, and the filing of the complaint in fore-

closure shall be conclusive notice of the exercise of such option by the mortgagee. [58]

Tenth: In the event this mortgage is foreclosed, the decree of foreclosure may provide that the property therein described be ordered sold en masse, or in separate lots or parcels, at the option of the plaintiff in such action.

Eleventh: It is hereby agreed, as a part of the security of the mortgagee hereunder, that if default should be made in the payment of the principal of said promissory note, or if default should be made in the payment of any installment of interest thereon when due, or if default should be made in any other payment in this mortgage provided to be made, or if default should be made in any of the covenants and agreements herein provided to be performed by said mortgagor, then, and in each and every such event, the mortgagee, without any limitation or restriction by any present or future law, shall have the absolute right, upon the filing of a bill in equity or upon any other commencement of judicial proceedings to enforce any right under this mortgage, including the foreclosure of the same, to the appointment of a receiver of the property and premises hereby mortgaged, and of the tolls, earnings, revenues, rents, issues, profits, and other income thereof, and that said receiver shall have full power to collect all such income and after paying all necessary expenses of such receivership and of the operation,

maintenance and repair of said property, shall apply the balance to the payment of any sums due hereunder, such receiver to have such other powers as the Court making such appointment may confer.

Twelfth: The mortgagor agrees that the mortgagee may at any time, without notice, release portions of said mortgaged premises from the lien of this mortgage without affecting the liability of any corporation or person for the payment of the said indebtedness or the lien of this mortgage upon the remainder of the mortgaged premises for the full amount of said indebtedness then remaining unpaid.

This mortgage is also given for the purpose of securing future advances in a sum not exceeding One Hundred Fifty Thousand Dollars, (\$150,000.00) which said sums so advanced shall be equally secured [59] by this mortgage, and bear the same rate of interest.

Thirteenth: The mortgagor hereby mortgages the property hereinbefore described, to secure the performance of every promise and agreement herein contained, direct or conditional, and to secure the repayment to the mortgagee of all sums paid, laid out or expended by the said mortgagee under the terms of this mortgage, and also to secure the attorney's fees and costs provided for by this mortgage in case of a foreclosure thereof.

Fourteenth: Every covenant, stipulation and agreement herein contained shall bind and inure to the benefit of said parties, their heirs, executors, administrators or assigns.

The above and foregoing note and mortgage are made, executed and delivered in pursuance of a resolution duly passed by the Board of Directors of said mortgagor, at a legal meeting thereof duly convened and held on the day of

In Witness Whereof, The said mortgagor has hereunto caused its corporate name and seal to be affixed by its President and Secretary thereunto duly authorized the day and year in this indenture first above written.

I. N. VAN NUYS BUILDING
COMPANY,

By ANNIS VAN NUYS,
Vice President.

By J. B. VAN NUYS,
Secretary.

State of California,
County of Los Angeles—ss.

On this 1st day of March in the year of our Lord One Thousand Nine Hundred Thirteen before me Nellie Lemert, a Notary Public in and for said county, personally appeared Annis H. Van Nuys, known to me to be the Vice President, and J. B. Van Nuys known to me to be the Secretary of Van Nuys Building Company, the corporation that executed the within and foregoing instrument, and known to me to be the persons who executed the within instrument on behalf of the corporation therein named and acknowledge to me that such corporation executed the same.

Witness my hand and official seal the day and year in this certificate first above written.

NELLIE LEMERT

Notary Public in and for the County of Los Angeles, State of California. [60]

In the Superior Court of Los Angeles County,
State of California

No. 182011

TITLE INSURANCE & TRUST COMPANY, a
Corporation, Executor of the Last Will and
Testament of Susanna H. Van Nuys, deceased,
Plaintiff,

vs.

I. N. VAN NUYS BUILDING COMPANY, a
Corporation,
Defendant.

ANSWER

Now comes the above named defendant, I. N. Van Nuys Building Company, a corporation, and for answer to the complaint herein filed, admits, denies and alleges as follows:—

I.

Defendant admits each and every allegation and paragraph of said complaint contained. In making this admission defendant assumes that the payments of interest, alleged in paragraph IV of said Complaint to have been made on the said promissory note, were made in cash.

First Separate Defense

Further Answering Said Complaint and As and For a Separate, and further defense thereto and to the alleged cause of action set forth therein, defendant alleges:

I.

That there is now and was during all the time mentioned in said Complaint, and at the time of the commencement of this action and at the time of the death of Susanna H. Van Nuys, deceased, in full force and effect in the State of California, Subdivision 1 of Section 337, Pt. 2, Tit. 2, Ch. 3, C.C.P. which provides the time in which an action on a written contract must be commenced, which subdivision is in words and figures as [61] follows:

Section #337.

“Within four years. 1. An action upon any contract, obligation or liability found upon an instrument in writing.”

II.

That by reason of the failure of the said plaintiff or the said Susanna H. Van Nuys to commence an action to enforce the said note and/or foreclose the said mortgage within four years after the 1st day of March, 1916, the within action is barred by the Statute of Limitation hereinabove set forth.

Second Separate Defense

Further Answering Said Complaint and As and For a Separate, and further defense thereto and to the alleged cause of action set forth therein, defendant alleges:

I.

That there is now and was during all the times mentioned in said Complaint and at the time of the

commencement of this action and at the time of the death of the said Susanna H. Van Nuys, deceased, in full force and effect in the State of California, Section 360, Pt. 2, Tit. 2, Ch. 4, C.C.P. which is as follows:—

Section #360.

“Acknowledgment or new promise must be in writing. No acknowledgment or promise is sufficient evidence of a new or continuing contract, by which to take the case out of the operation of this title, unless the same is contained in some writing, signed by the party to be charged thereby.”

II.

That the said defendant did not at any time after the execution of said promissory note and mortgage, to-wit, March 1, 1913, acknowledge said note and/or mortgage or promise to pay said note and/or mortgage in writing or otherwise, and said defendant did not at any time renew, extend or revise said note and/or mortgage or make any writing concerning same, and by [62] reason thereof and the laches of said plaintiff and the said Susanna H. Van Nuys to commence an action on said note and/or mortgage prior to March 1, 1920, this said action is barred.

Wherefore, defendant prays that plaintiff take nothing by reason of its complaint and defendant be dismissed with its costs.

CLAUDE I. PARKER,
RALPH W. SMITH,

Attorneys for Defendant.

State of California,
County of Los Angeles—ss.

J. B. Van Nuys, being duly sworn, deposes and says:

That the defendant in the above entitled action is a corporation; that he is an officer thereof; to-wit, President; that he has read the foregoing Answer and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters that he believes it to be true.

/s/ J. B. VAN NUYS.

Subscribed and sworn to before me this 30th day of October, 1925.

/s/ MARGUERITE LeSAGE,
Notary Public, in and for the County of Los Angeles, State of California. [64]

In the Superior Court of Los Angeles County,
State of California

No. 182011

TITLE INSURANCE & TRUST COMPANY, a
Corporation, Executor of the Last Will and
Testament of Susanna H. Van Nuys, Deceased,
Plaintiff,

vs.

I. N. VAN NUYS BUILDING COMPANY, a
Corporation,
Defendant.

FINDINGS OF FACTS, AND CONCLUSIONS OF LAW

This cause came on regularly for trial on the 4th day of November, 1925, before the Court without a jury, a jury trial having been duly waived by the respective parties, the Honorable Albert Lee Stephens presiding, and Harry A. Chamberlin, Esq., appearing as attorney for plaintiff, and Ralph W. Smith, Esq., of Claude I. Parker and Ralph W. Smith, appearing as attorney for defendant, and from the evidence, oral and documentary, introduced, the Court finds the facts as follows, to-wit:—

Findings of Fact

I.

That all of the allegations contained and set forth in the complaint and answer are true.

II.

That the plaintiff and defendant were, at all times mentioned herein, and now are, corporations, and that the plaintiff corporation is now, and has been since the 5th day of June, 1923, the duly appointed, qualified and acting executor of the last Will and Testament of Susanna H. Van Nuys, who died on the 1st day of May, 1923, in the County of Los Angeles, State of California. [65]

III.

That the defendant corporation, by and through its duly authorized officers and agents, on March 1st, 1913, at Los Angeles, California, made, executed and delivered to Susanna H. Van Nuys its written promissory note for the principal sum of \$400,000.00, a copy of which note is fully set forth in plaintiff's complaint and in the mortgage attached thereto, marked "Exhibit A," and made a part thereof.

IV.

That the defendant, at the same time and place, made, executed and delivered to Susanna H. Van Nuys a mortgage securing the payment of the principal sum and interest as mentioned in said note, and the various other sums agreed to be paid under the terms of said mortgage and note, a copy of which is attached to plaintiff's complaint marked "Exhibit A"; that said mortgage was duly acknowledged by the makers thereof but the same was not

recorded, or caused to be recorded, by Susanna H. Van Nuys, nor has the same been recorded since her death.

V.

That the interest on said note and mortgage, up to and including December 31, 1922, was paid in cash by the defendant corporation to Susanna H. Van Nuys, and that no further or additional sum has been paid or received thereon, either on account of interest, principal or otherwise.

VI.

That there was never any written acknowledgment or new promise relating in any manner to said note by the maker thereof, or anyone for or on its behalf; that neither said note or mortgage were at any time renewed or extended, or the terms and conditions thereof altered or changed in any manner since the execution thereof. [66]

VII.

That said note and mortgage became barred by the provisions of Subdivision One (1) of Section 337 of the Code of Civil Procedure of the State of California, as set forth in the defendant's answer herein, on March 1, 1920, and was so barred at the time of the death of the said Susanna H. Van Nuys on May 1, 1923, and has been barred at all times subsequent thereto; that said note and mortgage were not, nor were either of them, at the time of the death of said Susanna H. Van Nuys, or at any

time, subsequent to March 1, 1920, nor are they, or either of them, now, a valid and subsisting obligation or enforceable claim or debt, and said note is hereby filed as an exhibit herein, and the same cancelled.

VIII.

That said note and mortgage were included and listed by the plaintiff corporation as the executor of the last Will and Testament of Susanna H. Van Nuys, deceased, as part of the assets of the estate of said deceased in the inventory of said estate duly returned and filed by it and appraised therein as of no value.

IX.

That by reason of the failure of Susanna H. Van Nuys to institute an action to enforce the payment of said note and/or foreclose the said mortgage securing the same within four (4) years after the 1st day of March, 1916, the date upon which the same matured, said note and mortgage became barred by the statute of limitations as set forth and contained in the provisions of Subdivision One (1) of Section 337 of the Code of Civil Procedure, and the same were so barred at the time of the death of said Susanna H. Van Nuys on May 1, 1923, and are now barred.

Conclusions of Law

As a Conclusion of Law from the foregoing facts, the [67] Court finds that the plaintiff is not entitled

to judgment against the defendant; that the note and mortgage securing the same, and each of them, is, and are, barred by the statute of limitations and were so barred at all times subsequent to March 1, 1920; that the plaintiff and its successors in interest are estopped and debarred from enforcing the same or asserting any claim or right by reason thereof; that by reason thereof the defendant is entitled to judgment herein against the plaintiff for its costs incurred herein, and

It Is Ordered that judgment be entered accordingly.

Dated: November 6th, 1925.

/s/ ALBERT LEE STEPHENS,
Judge of the Superior Court.

In the Superior Court of Los Angeles County,
State of California

No. 182011—Dept. 6

TITLE INSURANCE & TRUST COMPANY, a
Corporation, Executor of the Last Will and
Testament of Susanna H. Van Nuys, Deceased,
Plaintiff,

vs.

I. N. VAN NUYS BUILDING COMPANY, a
Corporation,
Defendant.

JUDGMENT

This cause came on regularly for trial on the 4th day of November, 1925, in Department Six (6) of the above-entitled Court, the Honorable Albert Lee Stephens, presiding, and Harry A. Chamberlin, Esq., appearing as attorney for the plaintiff, and Ralph W. Smith, Esq., of Claude I. Parker and Ralph W. Smith, appearing as attorney for the defendant. A trial by jury having been duly waived by the respective parties, the action was tried before the Court sitting without a jury, and evidence, both oral and documentary, having been introduced, and the evidence closed and the cause argued, the same was thereupon submitted to the Court for consideration and decision, and after due deliberation thereon the Court files its Findings of Fact and Conclusions of Law herein and orders that judgment be entered herein against the plaintiff,

Title Insurance & Trust Company, a corporation, Executor of the Last Will and Testament of Susanna H. Van Nuys, deceased, and in favor of the defendant, I. N. Van Nuys Building Company, a corporation.

Now, Therefore, by reason of the law and the finding aforesaid, It Is Hereby Ordered, Adjudged and Decreed that the plaintiff, Title Insurance & Trust Company, a corporation, Executor of the [69] Last Will and Testament of Susanna H. Van Nuys, deceased, take nothing by this action, and that the defendant, I. N. Van Nuys Building Company, a corporation, do have and recover of, and from the said plaintiff, its costs and disbursements incurred herein and taxed in the sum of \$.....

Dated, November 6th, 1925.

/s/ ALBERT LEE STEPHENS,
Judge of the Superior Court.

EXHIBIT 4-D

I. N. Van Nuys Building Company

Directors' Resolution Increasing Stated Capital

Whereas, the books of account of this corporation now show that this corporation has a stated capital of \$1,315,000 and a paid-in or donated surplus of \$400,000, and it is deemed to be to the best interests of this corporation and its shareholders that said \$400,000 of paid-in or donated surplus be transferred to the stated capital account and

that the stated capital of this corporation be thereby increased;

Now, Therefore, Be It Resolved that the stated capital of this corporation be increased from \$1,315,000 to \$1,715,000; and

Resolved, Further, that the treasurer or accountants of this corporation be and they hereby are authorized and directed to transfer \$400,000 of the paid-in or donated surplus of this corporation to its stated capital account. [71]

EXHIBIT 5-E

I. N. Van Nuys Building Company

Directors' Resolution Authorizing Reduction of Stated Capital

Whereas, this corporation now has issued and outstanding 13,150 shares, all of one class, of the par value of \$100 each; and

Whereas, the stated capital of this corporation has recently been increased to \$1,715,000 by a transfer of \$400,000 of donated or paid-in surplus to stated capital; and

Whereas, it is deemed to be to the best interests of this corporation that its stated capital be reduced from \$1,715,000 to \$1,315,000, the latter being the aggregate par value of the outstanding par value shares of this corporation; and

Whereas, this corporation has no outstanding shares entitled to preference upon liquidation, and

the stated capital of this corporation as so reduced will be equal to the aggregate par value of all par value shares of this corporation to remain outstanding after such reduction;

Now, Therefore, Be It Resolved that the stated capital of this corporation be reduced from \$1,715,000 to \$1,315,000, the amount of such reduction being \$400,000; and

Resolved, Further, that the officers of this corporation be and they hereby are authorized and directed to procure the approval of these resolutions and the reduction of stated capital herein authorized, by the vote or written consent of the holders of a majority of the outstanding shares of this corporation, and to take such further action as may be necessary and proper to effect the reduction of stated capital of this corporation from \$1,715,000 to \$1,315,000 in accordance with the laws of the State of California. [72]

EXHIBIT 6-F

I. N. Van Nuys Building Company

Directors' Resolution Authorizing Distribution of Reduction Surplus

Whereas, by proceedings heretofore duly taken in accordance with the laws of the State of California, the stated capital of this corporation has been reduced from \$1,715,000 to \$1,315,000, and there has resulted from such reduction of stated capital a surplus of \$400,000; and

Whereas, said surplus of \$400,000 resulting from said reduction of stated capital has heretofore been duly transferred to a reduction surplus account and it is deemed to the best interests of this corporation and its shareholders that assets of this corporation, in the form of cash in the amount of \$400,000, be distributed to shareholders of this corporation, from time to time and in such amounts as may be determined by the directors of this corporation;

Now, Therefore, Be It Resolved that the sum of \$400,000 be distributed pro rata in cash to the shareholders of this corporation from time to time in such amounts per share, and to shareholders of record on such dates, as may be hereafter determined by the directors of this corporation; and

Resolved, Further, that the board of directors of this corporation hereby determines that by such distribution or withdrawal of \$400,000 this corporation will not be rendered unable to satisfy its debts and liabilities when they fall due, and that the assets of this corporation after such distribution or withdrawal, taken at their fair present value, will at least equal one and one-quarter times its debts and liabilities; and

Resolved Further, that the president or vice president and the treasurer or assistant treasurer of this corporation be and they hereby are authorized and directed to sign, acknowledge and file with the Secretary of State of the State of California,

at least fourteen days before such distribution, a certificate in compliance with Section 348(b) of the California Civil Code;

Resolved, Further, that the officers of this [73] corporation be and they hereby are authorized and directed to file in the office of the County Clerk of Los Angeles County, California, being the county in which this corporation has its principal office, a copy of said certificate duly certified by said Secretary of State, and to take such further action as may be necessary and proper to effect the distribution of the assets of this corporation hereinabove authorized, in accordance with the laws of the State of California. [74]

EXHIBIT 7-G

I. N. Van Nuys Building Company

Directors' Resolution Adopted

January 21, 1924

Resolved, That the note for \$400,000 dated February 27th, 1913, now carried on the books of the Company as "Notes Payable" and which note has become outlawed and is no longer enforceable; therefore, be it

Resolved, That the said amount is hereby ordered transferred from "Notes Payable Account" to "Surplus—Paid in Account" by the proper entries on the books of the Company forthwith.

Filed T.C.U.S. June 12, 1946. [75]

Official Report of Proceedings
Before

The Tax Court of the United States

Docket No. 6415

ANNIS VAN NUYS SCHWEPPE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

EXCERPTS FROM THE TRANSCRIPT
OF TESTIMONY

Hearing at Los Angeles, California, June 12, 1946

Evidence on Behalf of Petitioner

Thereupon, the Petitioner, to maintain the averments of her petition, introduced the following proof:

Whereupon,

JAMES R. PAGE

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Wall:

Q. Will you state your full name?

A. James R. Page.

(Testimony of James R. Page.)

Q. You are the husband of Kate Van Nuys Page, are you not, Mr. Page? A. Yes, sir.

Q. And therefore the son-in-law of Mrs. Suzanna H. Van Nuys? A. Yes, sir. [77]

Q. You married Mrs. Van Nuys' daughter sometime before Mrs. Van Nuys' death, did you not, Mr. Page? A. 1914.

Q. Were you connected with the I. N. Van Nuys Building Company prior to the death of Mrs. Suzanna Van Nuys in 1923? A. No, sir.

Q. Were you familiar with Mrs. Van Nuys' financial affairs during her lifetime?

A. Yes, to some extent. To a very considerable extent.

Q. Did she consult with you concerning her affairs from time to time?

A. She discussed her affairs with me. I wouldn't say I was a consultant.

Q. During what period approximately, Mr. Page, did she discuss her affairs with you?

A. Oh, 1915 to the time of her death.

Q. Were you familiar with the \$400,000.00 loan which was made by Mrs. Van Nuys to the Van Nuys Building Company in 1913? A. I was.

Q. And with the note that she held evidencing that loan?

A. I knew that a note existed. I had never seen the note.

Q. Did Mrs. Van Nuys ever refer to the note or

(Testimony of James R. Page.)

to that [78] loan in conversations with you during her lifetime? A. Oh, yes, frequently.

Q. Approximately when were those references made? A. Sunday lunch.

Q. Can you identify approximately the years during which those took place?

A. Oh, I would think from 1915 to, let me see, I was at war a couple of years, 1915 and 1916, and then from 1918 to 1920, around through there.

Q. What did she say to you during those conversations concerning that note, Mr. Page?

A. Well, when she distributed the balance of her husband's estate to her children, she was very emphatic about the fact that she wanted the building to belong to the children, that she never intended to collect the \$400,000.00.

Mr. Tonjes: That is objected to, your Honor, and I move the last portion of that answer be stricken.

It is quite apparent now that what counsel is endeavoring to do is to prove that there was a gift and some sort of a donative action taken with regard to this \$400,000.00. I submit that before there can be any discussion of the intent of the parties there must be some showing that a delivery of some kind of the subject matter was made, either symbolic or otherwise. There has been no showing of that fact to this [79] present moment.

Mr. Wall: If your Honor please, I believe counsel's objection goes rather to the weight than

(Testimony of James R. Page.)

to the admissibility of this testimony. Mr. Page has testified to declarations made by Mrs. Van Nuys, who is now dead, which are definitely contrary to her pecuniary interest at the time and which I believe are clearly admissible under that rule.

The Court: I think in view of the issue that is drawn in this case it would be admissible. Of course, whether or not the circumstances narrated by this witness and perhaps by others would amount to a gift would be a question apparently that the Court will have to decide, but I would overrule the objection.

Q. (By Mr. Wall): Do you know, Mr. Page, whether or not Mrs. Van Nuys ever made any effort to collect the note during her lifetime?

A. Not that I know of. I would not have known it, though, because I had nothing to do with the affairs of the company.

Q. Did she ever mention the note to you during, say, the last year of her life, 1922 and 1923?

A. I don't remember that she did. I don't remember that detail.

Mr. Wall: I have no further questions, Mr. Tonjes.

Mr. Tonjes: No questions.

(Witness exused.) [80]

Mr. Wall: I would like to call Mr. J. B. Van Nuys.

Whereupon,

JAMES BENTON VAN NUYS

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Wall:

Q. Will you state your full name, please, Mr. Van Nuys? A. James Benton Van Nuys.

Q. You are the son, Mr. Van Nuys, of I. N. Van Nuys and Suzanna H. Van Nuys, are you not?

A. Yes, sir.

Q. Are you now associated with the I. N. Van Nuys Building Company? A. I am.

Q. Are you an officer of that company at the present time?

A. I am president of the company.

Q. Were you associated with the company prior to the death of your mother in May, 1923?

A. I was.

Q. Were you an officer of the corporation at that time?

A. I was. I think I was secretary of the company at that time. [81]

Q. Beg pardon?

A. I was secretary of the company at that time.

Q. Do you recall how long before her death you became secretary of the company?

A. I think I was, if my recollection is correct, I was secretary from the inception of the company, organization of the company.

(Testimony of James Benton Van Nuys.)

Q. Was Mrs. Suzanna Van Nuys an officer of the company after the death of your father, I. N. Van Nuys?

A. I think she was president of the company.

Q. How *did* she continue as president?

A. I think until her death.

Q. Are you familiar, Mr. Van Nuys, with the \$400,000.00 loan which was made to the Van Nuys Building Company by Mrs. Van Nuys?

A. I am.

Q. Did Suzanna Van Nuys, your mother, ever take any action during her lifetime to collect the balance of the note?

A. No, sir, she did not.

Q. Did your mother ever refer to the note in conversation with her during her lifetime?

A. Many times.

Q. Can you place those conversations, approximately in time as to years?

A. Well, at various periods she distributed to her [82] children or gave to her children certain real properties and certain securities, and at those various times the condition of her affairs was discussed quite definitely, and my recollection of those times, she had stated repeatedly that she did not intend to enforce the collection of the note or collect on the note, did not expect to collect the funds represented by the note.

Q. I am not sure you quite answered my question, in point of years. You said that she did mention it several times and at the times of distribu-

(Testimony of James Benton Van Nuys.)

tions. Can you recall the approximate years during which those conversations took place?

A. Well, I think she distributed or gave to us in 1918 or 1919——

Q. It is in evidence here that she gave the stock of the Building Company in 1919, Mr. Van Nuys. Does *the* refresh your recollection?

A. That was the date, I think, quite definitely, and prior to that time she also gave us some real property she owned that was not part of my father's estate, in San Francisco, and her various affairs were discussed there. She made distribution or gifts to us of certain real properties. I think the same time she gave us this stock that she had inherited from my father, and at those various times definitely, I think, the \$400,000.00 note was discussed or mentioned by her. [83]

Q. What did she say concerning it?

A. That she did not expect to collect the note, and she considered that she was giving us the stock of the Building Company so the children owned the Building Company.

Mr. Wall: Thank you. I have no further questions.

Cross-Examination

By Mr. Tonjes:

Q. Mr. Van Nuys, were you active in the affairs of the Van Nuys Building Company?

A. Yes, sir.

Q. And were you active in it during the years

(Testimony of James Benton Van Nuys.)

1919 and sometime prior thereto? A. Yes, sir.

Q. For how long a period?

A. Well, I was secretary of the company and active in it from its formation, which was in 1910 or '11, sometime like that.

Q. So you were active in the affairs of the corporation during all of that period?

A. Yes, sir.

Q. Did you direct its affairs to some extent?

A. Yes, sir.

Q. Would you say then you occupied a dominating position in the organization after your mother died?

A. Well, I personally have since her death, yes, I [84] have been chief executive officer.

Q. You say there had been some discussion with your mother with regard to whether or not this note would be paid?

A. Yes, particularly that she repeatedly stated to me that she did not expect the note to be paid.

Q. She did not expect it to be paid?

A. Yes.

Q. Do you know upon what she based that expectation?

A. She was fully aware that she could collect the note, the company was solvent, so it must have been that she did not intend to collect it, had no desire to collect it.

Q. At what time was that intention first expressed?

A. I don't know what time, but at various times,

(Testimony of James Benton Van Nuys.)

particularly I should say, to the best of my recollection, when this distribution of stock made by her or her gift of this stock to her children, and also the gift of certain real properties to her children.

Q. Would you say that she never expressed any thought of not collecting the debt until after the stock was given to the children?

A. No, I think she expressed that many times before, even before the stock was given to the children as well as after the stock was given to the children.

Q. Can you fix a date that she first made any such expression? [85]

A. Well, I could quite definitely fix it by ascertaining when certain real property in San Francisco was given to the children, but my recollection, of course, it is 25 years and it pretty hard to fix dates 25 years back.

Q. Were all those expressions made informally at home or at some meeting of the stockholders or directors of the corporation?

A. Well, I should say the vast majority were made informally at least at family lunches or—we are quite clannish and we had various meetings, formal and informal, even to this date, and those statements were made under those circumstances. I do not have any distinct recollection it was ever mentioned at a formal organization meeting, although I certainly would not testify that it was not made there.

Q. Did she attend any of the meetings at all?

A. Oh, yes, sir.

(Testimony of James Benton Van Nuys.)

Q. But you don't recall that ever having been discussed at the meetings, is that right?

A. No, I don't recall that it was not discussed either.

Yes. Now, how much capital did the organization have?

A. 1,300,000 shares, or somethink like that,—or 1,300,000 dollars.

Q. So with regard to the relative importance of the \$400,000 note to the total capital of the corporation, it [86] was a substantial sum, was it not?

A. Yes.

Q. And ordinarily items of contributions to capital to the extent of \$400,000.00 in amount would be very seriously thought over and discussed in formal meetings, would they not?

A. Well, this is the only time this corporation ever had a \$400,000.00 gift to it, so at no other time did the subject come up.

Q. When the expressions of your mother were made, did you give any consideration at all to the effect it might have on the payment of interest on the note?

A. I don't think so. I don't think the question of interest came up.

Q. As a matter of fact, interest was paid on the note until your mother died, isn't that correct?

A. Correct.

Q. It was paid to her semi-annually?

A. Yes, sir.

(Testimony of James Benton Van Nuys.)

Q. And the last payment was made in November, 1922? A. I am not sure of the date.

Q. In any event, payment was made up to the last period during your mother's life?

A. Yes, sir.

Q. Did you give any thought to whether or not the company [87] had any right to pay interest on a debt which it did not owe?

A. No, I did not. In fact, the note had been overdue in 1916, and I presume it was a matter of——

The Court: You mean it had become due in 1916?

The Witness: Yes, sir, and I think just as a matter of course of business that interest was paid on it and continued to be paid. I don't think the question ever came up, so I didn't realize that the note had—the statute of limitations had cancelled it, been paid.

Q. (By Mr. Tonjes): You would not have paid the interest on the note if you did not recognize it as a subsisting obligation, would you?

A. I would have to answer that by saying that the interest was paid semi-annually since 1913, was that when the note was created?

Q. Yes.

A. And I don't think—it was a family affair. It was paid semi-annually, just was paid semi-annually.

(Testimony of James Benton Van Nuys.)

Q. I don't want to start an argument with you, Mr. Van Nuys, but there seems to me to be a strong inconsistency in the situation here. If the interest was paid, insofar as the corporation was concerned, it must have recognized that it was indebted to Mrs. Van Nuys, your mother, to the extent of \$400,000.00, isn't that correct? [88]

A. Yes, I say I am—I don't know whether I can agree with you on that interest, whether or not it created any—I know that this was set up in a certain manner like certain other instruments and the interest was paid. Now, I don't think it ever occurred to us that the note had become exterminated by the statute of limitations. I don't think that question was considered. I know it was never brought up and discussed.

If it had been brought up and discussed, then I could definitely tell you she stated she knew that it was paid or had been paid.

Q. Did you inquire into the effect of the Statute of Limitations on this note?

A. Inquire into the process of the Statute, you say? The title company raised it at that time as executors.

Q. Was there any question raised with regard to the effect of the Statute of Limitations, we will say, in 1920 or '21?

A. No, sir, I don't think anybody was aware of the Statute of Limitations at that time.

Q. Do you know why no formal cancellation of the note or surrender of the note was had by your

(Testimony of James Benton Van Nuys.)

mother if she never expected to collect the note?

A. I know of no reason.

Q. The accounts were adjusted for the first time to show [89] that the note no longer constituted an obligation in 1924, is that correct?

A. I am not sure.

Mr. Wall: I will stipulate that it was so.

The Witness: I have no certain recollection, but I think the dates are all in evidence.

Q. (By Mr. Tonjes): Do you recall what the circumstances were which prompted the action regarding the transfer of that sum from a debt to what has been described in the stipulation as surplus paid in, at or about that time?

A. No, I can't recall positively, but I know that the earnings of the corporation from current operations, a certain portion of those earnings were accumulated for further future investments. Then there came a time when the earnings—when the accumulation was no longer thought necessary by the directors, and the extra earnings of the company, as I remember, constituted a surplus account, and the transfer was made to surplus account, which was the proper legal way to handle those distributions, I understand.

Q. Yes. But do you know what prompted that particular action at that time?

A. I don't know at this time. I don't recall. But I know there was a time when all the earnings were not distributed, they were accumulated, then

(Testimony of James Benton Van Nuys.)
there was a time when [90] all the earnings were distributed.

Q. The time I am concerned with is at the time that you made certain transfers to surplus account, Mr. Van Nuys, and we have a stipulation that certain resolutions concerning the further transfer of this sum of \$400,000.00 were made in 1938. Can you recall the circumstances of the adoption of those resolutions? A. No, I do not at this time.

Q. You don't know what prompted that action at or about 1938?

A. No, I haven't any recollection at this time.

Q. Or why the question was brought up at that time?

A. No more than what I have said. I think it was on account of the size of the distributions.

Q. I will make the statement over again and get my question right, Mr. Van Nuys. The first question I asked a moment ago when you gave me your answer related to some resolutions back in 1924, that is when the amount was charged on your books, when the amount represented by the note was put in surplus paid in. A. Yes.

Q. Then after that, in 1934 and 1938, there were some further resolutions concerning the change of characterization of that sum. Do you have any knowledge now of what occurred at that time which prompted the adoption of those resolutions [91] at that time?

A. No. As I stated, I should judge by that action there that there was a question raised about

(Testimony of James Benton Van Nuys.)

how that should be treated in the distribution of securities. Of course, it seems logical, I should say, in 1924 was about the time that Mrs. Van Nuys', my mother's estate was settled, and in our opinion the people of the company had determined through what she said that there had been a gift of that note and that it no longer existed, and therefore the corporation probably had instructions from its attorneys as to that and this apparently is the course that they advised. That would be the 1928 transaction.

Then the 1928 transaction was probably a distribution made and it was set up that way by the board of directors.

Q. Did you seek the advice of counsel in that connection? A. Yes, sir.

Q. Who was the counsel?

A. O'Melveny & Myers.

Q. Were they your tax counsel as well?

A. Yes, our counsel.

Q. Your general counsel? A. Yes, sir.

Mr. Tonjes: I think that is all, Mr. Van Nuys.

Redirect Examination

By Mr. Wall: [92]

Q. May I ask you one more question, Mr. Van Nuys? It is true, is it not, that this I. N. Van Nuys Building Corporation has been and is still a family corporation where all of the stock, or substantially all of the stock has been held within your own family? A. Yes, sir.

Q. And there were no other persons beneficiaries or interested in the company except the members of your family?

A. That is right. There are a few others who have qualifying shares to be directors but all of the others are held by the family.

Mr. Wall: That is all.

Mr. Tonjes: No further questions. Thank you.

(Witness excused.)

Mr. Wall: I would like to call Mr. Ralph W. Smith.

Whereupon,

RALPH W. SMITH

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Wall:

Q. State your name for the reporter, please.

A. Ralph W. Smith.

Q. What is your occupation or profession, Mr. Smith? [94]

A. I am an attorney.

Q. Did you at one time represent the executor and heirs of the Estate of Suzanna H. Van Nuys, deceased?

A. I did.

Q. In connection with the determination of the Federal Estate Tax on that estate?

A. I did.

(Testimony of Ralph W. Smith.)

Q. Do you recall approximately when that representation took place?

A. Oh, about 20 years ago, 1925 or '26, along in there.

Q. Do you recall, Mr. Smith, a controversy in that connection concerning the inclusion in the estate of Mrs. Van Nuys for Federal Tax Purposes of the value of a certain \$400,000.00 note of the I. N. Van Nuys Building Company, dated March 1, 1913, and payable in 1916 to Suzanna H. Van Nuys?

A. I know there was a note for \$400,000.00. The date I don't remember exactly.

Q. Mr. Smith, it is in evidence here that under date of September 17, 1925, the Commissioner of Internal Revenue sent an official 30-day letter to the executor of Mrs. Van Nuys' estate advising about the tentative determination of a deficiency in the Federal Estate Tax, basing his determination in part on a tentative determination that the \$400,000.00 note to which I have just referred should be included as an asset of the estate and should be valued at its [94] face amount of \$400,000.00. Do you recall that?

A. I do.

Q. It is also in evidence here, Mr. Smith, that in October, 1925, the Title Insurance & Trust Company as executor of Mrs. Van Nuys' estate commenced an action in the Superior Court against the I. N. Van Nuys Building Company on that note. Do you recall that action?

A. I do.

Q. Did you advise the institution of that action, Mr. Smith?

(Testimony of Ralph W. Smith.)

A. I think I did. It is my recollection that I did.

Q. Will you please state the circumstances under which you gave that advice?

A. Well, there was at the time a dispute as to the value of the note in that estate, and there was a question raised by the Inheritance Tax Department.

Mr. Tonjes: May I interrupt the witness, your Honor? Just to ask the counsel the materiality of this matter on these particular issues. I don't quite appreciate it.

Mr. Wall: The materiality is for the purpose of explaining the circumstances under which the action was brought on the note by the executor of Mrs. Van Nuys' estate, which was commenced in 1925. That case on the note I expect will be relied upon by counsel for the respondent as an indication that the note was considered by the executor and by [95] the heirs of Mrs. Van Nuys as being alive even after her death, contrary to the testimony which the petitioner has presented. I think the Petitioner is entitled to show the circumstances under which the action was prosecuted, to give the facts their true setting.

The Court: I will hear the testimony. You may answer.

The Witness: Will you read the answer as far as I had gone.

(The answer was read.)

The Witness: Considered the note a valid and subsisting obligation of the estate, and as I recall,

(Testimony of Ralph W. Smith.)

there was a compromise in the Inheritance Tax Department as to the value of the note on the basic date. I was of the opinion very definitely that the note had no value since the Statute of Limitations had run, and the only evidence of a recognition of the obligation was the payment of the interest. The State of California, I know, took the position that the payment of interest alone prevented the running of the Statute or was a renewal of the obligation, and my position was when I took over the case to the Federal that that was not sufficient right or recognition to prevent the tolling of the statute. For that reason I felt it was necessary and I knew it would become necessary later for the Federal Government purposes to get an adjudication, and so I [96] recommended to the Executor that I felt it advisable for the Executor as such to bring an action to determine just the status of the note as to its validity and its collectability, and they brought that action in the Superior Court of this County, and an answer was filed and the matter was heard and findings and a judgment was entered, as I remember it, holding that the note did not have value by reason of the fact that the Statute of Limitations had tolled on the obligation.

Q. When you mentioned the Inheritance Tax authorities, Mr. Smith, you were talking about the California State Inheritance Tax authorities, were you?

A. That is right.

Q. They had raised the question of the value of the note there?

A. That is true.

(Testimony of Ralph W. Smith.)

Q. In addition to the question raised by the Federal Estate Tax office?

A. It was our idea to determine that, and we had a judgment and it was settled before we got to the Federal Estate Tax. That came in later on.

Q. Mr. Smith, when you advised the bringing of this action, did you have then any knowledge of the intentions of Mrs. Suzanna H. Van Nuys with respect to the collection of that note? [97]

A. No, I knew nothing about that. You are talking about this testimony about the gift here?

Q. That is correct.

A. I didn't know anything about that until yesterday.

Mr. Wall: That is all.

Cross-Examination

By Mr. Tonjes:

Q. Mr. Smith, you stated, I believe, that you came to the conclusion that this note was of no value because the Statute of Limitations had run.

A. That is true.

Q. That was when?

A. That was in—I came in the picture, I think, in about 1925.

Q. Now, would the fact that the Statute of Limitations had run make the note valueless?

A. Well, the Statute, no, but it is an affirmative defense in a suit. Is that what you mean?

Q. Yes. It must be affirmatively pleaded and proven, is that correct? A. Yes.

(Testimony of Ralph W. Smith.)

Q. So that in the event that the defendant recognized his obligation to pay he could have a judgment rendered against him on that basis on a suit on the note?

A. Oh, yes, if the note—if he had not pleaded the [98] Statute of Limitations in this action, I assume that the Estate and the Executor would have gotten judgment.

Q. This was, of course, a family corporation, as you understood it? A. Entirely, yes.

Q. And the deceased was at one time one of the principal stockholders? A. That is true.

Q. And was the mother of the principal stockholders at the time of her death?

A. I don't get that.

Q. Under those circumstances, did you give any thought to the possibility that the corporation would honor this note?

A. Well, it didn't indicate that it intended to honor the note.

Q. Would you say that the payment of interest until the date of the death was an indication that it would honor the note or not?

A. Well, we have got dozens and dozens of cases in California——

Q. I am talking about this case, however.

Mr. Wall: I object to that.

Mr. Tonjes: He stated his opinion on that. I think I have a right to inquire into his reasons for his conclusion.

The Court: If he agreed with you on that, would that [99] have anything to do with this case? This

(Testimony of Ralph W. Smith.)

is a gift, it would seem. I will permit the answer, however. I will overrule the objection. Read the question, please.

(The question was read.)

The Witness: It may be so construed.

Q. (By Mr. Tonjes): In other words, you stated there was no indication which would lead you to believe that they would pay the note, and I am directing your attention to the fact that the corporation did pay interest right up to the date of death, and considering that fact and the fact that the corporation owed the money to the mother of the principal stockholders, did you consider those facts in arriving at your conclusion that the note had no value?

A. Well, I felt this: The note, in my opinion, had no value, because of the Statute of Limitations. Many other lawyers interested in this matter, this kind of a situation favored the view that payment of interest was sufficient to keep the note alive. I took the opposite position and the Court sustained me, and the District Court sustained me out here.

Q. But did you consider those factors, Mr. Smith?

A. No, I don't think I gave any consideration to them.

Mr. Tonjes: You did not. That is all.

Mr. Wall: I have no further questions. Thank you, [100] Mr. Smith. Petitioner rests, if your Honor please.

(Witness excused.)

Mr. Tonjes: The respondent rests, your Honor.

The Court: Very well.

Perhaps this case had better be briefed by Petitioner filing an opening brief and the Respondent an answering brief, and then the Petitioner file its final brief in the case.

Mr. Wall: That will be entirely satisfactory to me, your Honor.

The Court: Will fixing the date of August 1st for the opening brief be sufficient time?

Mr. Wall: August 1st, yes, your Honor, that is satisfactory.

The Court: And the Commissioner is given until September 1st to file his answering brief and the Petitioner may have until October 1st to file the reply brief.

Mr. Wall: Is that October 1st, your Honor?

The Court: Yes.

Mr. Wall: Thank you. That will be satisfactory.

Mr. Tonjes: Thank you, your Honor.

(Whereupon, at 10:45 a.m., June 12, 1946, the hearing in the above-entitled matter was closed.) [101]

[Title of Tax Court and Cause.]

STIPULATION SETTLING RECORD

The parties hereto, by their undersigned Counsel of record, hereby stipulate and agree pursuant to Rule 75(f) of the Rules of Civil Procedure for the District Courts of the United States, and Rule 30, paragraph 2 of the Rules of Practice and Procedure

of the Ninth Circuit Court of Appeals, that the parts of the record, proceedings and evidence to be included in the Record on Appeal in the above entitled matter shall consist of the following:

1. The docket entries of all proceedings before the Tax Court.
2. Pleadings before the Tax Court as follows:
 - (a) Petition for redetermination.
 - (b) Answer of Respondent.
3. The Findings of Fact and Opinion of the Tax Court. [102]
4. The decision of the Court.
5. Stipulation of fact filed herein together with Exhibits 1-A, 2-B, 3-C, 4-D, 5-E, and 6-F attached thereto, and Exhibit 7-G as admitted in evidence per stipulation in open Court.
6. Transcript of testimony adduced at the hearing of the above entitled proceeding at Los Angeles, California, on June 12, 1946, omitting therefrom the opening statements of Counsel commencing on page 2 thereof and extending down to the phrase "evidence on behalf of petitioner" on page 17 thereof.
7. The Petition for Review filed by the Petitioner in the above entitled case.

/s/ CHARLES OLIPHANT, CAR
Counsel for Respondent.

/s/ ELMO H. CONLEY,
/s/ BERT A. LEWIS,

Counsel for Petitioner.

Filed Dec. 17, 1947. [103]

[Title of Tax Court and Cause.]

PRAECIPE FOR RECORD

To the Clerk of The Tax Court of the United States:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, with reference to Petition for Review heretofore filed by the petitioner in the above case, a transcript of the record in the above case, prepared and transmitted as required by law and by the rules of said Court, and to include in said transcript the following documents, or certified copies thereof, to wit:

1. The docket entries of all proceedings before the Tax Court.
2. Pleadings before the Tax Court as follows:
 - (a) Petition for redetermination.
 - (b) Answer of Respondent. [104]
3. The Findings of Fact and Opinion of the Tax Court.
4. The decision of the Court.
5. Stipulation of fact filed herein together with Exhibits 1-A, 2-B, 3-C, 4-D, 5-E, and 6-F attached thereto, and Exhibit 7-G as admitted in evidence per stipulation in open Court.
6. Transcript of testimony adduced at the hearing of the above entitled proceeding at Los Angeles, California, on June 12, 1946, omitting

therefrom the opening statements of Counsel commencing on page 2 thereof and extending down to the phrase "evidence on behalf of petitioner" on page 17 thereof.

7. Stipulation Settling Record.

8. This Praeceptum.

/s/ ELMO H. CONLEY,

/s/ BERT A. LEWIS,

Attorneys for Petitioner.

Received and filed Dec. 17, 1947. [105]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 105, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 18th day of December, 1947.

[Seal] /s/ VICTOR S. MERSCH, EMT

Clerk, The Tax Court
of the United States.

[Endorsed]: No. 11818. United States Circuit Court of Appeals for the Ninth Circuit. Annis Van Nuys Schweppe, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed December 20, 1947.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit

No. 11,818

U. S. Tax Court Docket No. 6415

ANNIS VAN NUYS SCHWEPPE

vs.

COMMISSIONER OF INTERNAL REVENUE

STATEMENT OF POINTS AND DESIGNA-
TION OF RECORD UNDER RULE 19,
SUBDIVISION 6

Pursuant to provisions of subdivision 6 of Rule 19 of the above entitled Court, Petitioner hereby adopts as the statement of points upon which she

intends to rely on appeal, the Assignments of Error included in the petition for review within the Transcript of Record, said petition for review being found at page 32 of the original certified Record herein.

Petitioner further designates for printing the entire record as certified by The Tax Court of the United States to the Clerk of the above entitled Court.

ELMO H. CONLEY,
BERT A. LEWIS,
By /s/ BERT A. LEWIS,
Counsel for Petitioner.

Personal service of the foregoing Statement of Points and Designation of Record under Rule 19, Subdivision 6, is hereby acknowledged this 2nd day of January, 1948.

/s/ THERON L. CANDLE,
Asst. Atty. General.

[Endorsed]: Filed Jan. 12, 1948.